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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

1999 APR 26 P 4: 30

AZ CORP COMMISSION
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In the matter of

DOCKET NO. S-03177A-98-0000

FOREX INVESTMENT SERVICES
CORPORATION
2700 N. Central Ave., Suite 1110
Phoenix, AZ 85004

**POST HEARING
MEMORANDUM**

EASTERN VANGUARD FOREX LTD.
2700 N. Central Ave., Suite 1110
Phoenix, AZ 85004

(Securities Division)

c/o HWR Services Limited, Registered Agent
P. O. Box 71, Craigmuir Chambers
Road Town, Tortola
British Virgin Islands

EASTERN VANGUARD GROUP LIMITED
c/o AMS Trustees Limited, Registered Agent
Creque Building, Main Street, P. O. Box 116
Road Town, Tortola
British Virgin Islands

Arizona Corporation Commission
DOCKETED

APR 26 1999

K. (DAVID) SHARMA
Eastern Vanguard Forex Ltd.
P. O. Box 71, Craigmuir Chambers
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...

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5 TO FAI CHENG)
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San Francisco, CA 94109)

16 **Respondents.**)
17)
18)
19)

20 The Securities Division ("Division") of the Arizona Corporation Commission
21 ("Commission") hereby submits the following Post Hearing Memorandum in the above-captioned
22 matter.

23 **I.**
24 **STANDARD OF PROOF**

25 In administrative adjudication by the Commission, the standard of proof for alleged
26 violations of the Securities Act of Arizona ("SAA") is merely the preponderance of the evidence.

1 See *Steadman v. Securities and Exchange Commission*, 450 U. S. 91 (1981) (administrative
2 adjudication of federal securities laws antifraud violations). See also, *Geer v. Ordway*, 156 Ariz.
3 588, 589, 754 P.2d 315, 316 (Ct. App. 1987) (administrative adjudication of state motor vehicle
4 operator licensing law).

5 **II.**
6 **OFFER OR SALE OF UNREGISTERED SECURITIES**

7 The Division alleged that Respondents Forex Investment Services Corporation ("FISC"),
8 Eastern Vanguard Forex Ltd ("EVFL"), James Charles Simmons, Jr. ("Simmons") and Michael E.
9 Cho ("Cho") offered to sell or sold commodity investment contract securities within or from the
10 state of Arizona in violation of A.R.S. § 44-1841. This statute makes it unlawful to sell or offer for
11 sale securities within or from Arizona unless those securities are registered or otherwise exempt
12 from such registration. Respondent Simmons has not contested this allegation.

13 **A. Commodity Investment Contract Securities**

14 For purposes of the SAA, the term "Security" is defined at A.R.S. § 44-1801(23) to include
15 "commodity investment contract." At A.R.S. § 44-1801(6), "Commodity investment contract" is
16 defined in relevant part as "any account, agreement or contract for the purchase or sale, primarily for
17 speculation or investment purposes and not for use or consumption by the offeree or purchaser, of
18 one or more commodities ... Any commodity investment contract offered or sold, in the absence of
19 evidence to the contrary, is presumed to be offered or sold for speculation or investment purposes."
20 At A.R.S. § 44-1801(3), "Commodity" is defined in relevant part to include "any foreign currency."
21 Therefore, a commodity investment contract security under the SAA includes any account,
22 agreement or contract for the purchase or sale, primarily for speculation or investment purposes, of
23 any foreign currency.

24 A commodity investment contract under the SAA is entirely a creature of statute with the
25 definitions under A.R.S. § 44-1801(3) and (6) containing all its legal elements. Unlike the historical
26 "investment contract" also included in the definition of "Security" under A.R.S. § 44-1801(23), no

1 judicial gloss has accreted decisional law elements to the *commodity* investment contract.

2 The Division alleged that the EVFL foreign currency trading accounts ("EVFL Forex
3 accounts") offered and sold through FISC were commodity investment contracts within the meaning
4 of the SAA. Respondents except Simmons have virtually conceded by stipulation the factual basis
5 for this allegation:

6 14. According to sales literature provided to prospective investors, an investor
7 engages in leveraged trading on the international foreign currency spot market ("Forex")
8 through an EVFL account by buying or selling on margin fixed amounts of four foreign
9 currencies: the German Mark (DM 125,000), the Swiss Franc (SF 125,000), the British
10 Pound (£62,500) and the Japanese Yen (¥12,500,000). Each foreign currency lot or
11 "contract" is priced in U. S. dollars based on fluctuating currency exchange rates reported on
12 the Interbank Network, a global communication network of international banks.

13 15. Investors opened EVFL trading accounts through FISC by paying at least
14 \$10,000 as "Guarantee Money" and executing an EVFL "Customer's Agreement" and other
15 documents. Investor funds were deposited into an EVFL bank account in California as
16 "initial margin" to "secure" trading transactions. The "Customer's Agreement" and related
17 documents were retained indefinitely by FISC, with copies provided to EVFL. ...

18 16. Leveraged trading on an account was conducted by relaying investor buy or
19 sell orders through the FISC and TOKYO offices to an EVFL office in Portuguese Macau
20 on the Pacific coast of China, with all buy or sell contract prices set by EVFL. Trading was
21 leveraged because less than 5% of the price to buy or sell each currency contract was
22 reserved in the account as an earnest deposit or initial margin. EVFL imposed a minimum
23 "day trade" margin of \$1,000 for each contract (or "position") entered into ("opened") and
24 then liquidated ("closed") by an offsetting contract during the same business day. For each
25 contract opened but not closed until another business day, EVFL required a \$2,000
26 minimum "overnight trade" margin. ...

17 17. The currency contracts bought or sold through EVFL trading accounts
18 provided no settlement or delivery dates. Overnight positions could be maintained
19 indefinitely through successive business days, with only one trading commission charged by
20 EVFL upon position liquidation. Additional margin was required to maintain open positions
21 if adverse changes in currency prices rendered the minimum margin insufficient. EVFL
22 charged or paid daily interest on overnight positions depending on the currency and whether
23 the position was buy or sell. The interest charged was greater than the interest EVFL paid.
24 Whether a day trade or an overnight trade resulted in investor gain was determined by the
25 price difference between the opening position and the offsetting contract closing a position,
26 together with commission cost and daily interest charged or paid by EVFL on overnight
positions.

17 18. The leveraged trading accounts offered or sold by EVFL through FISC were
18 promoted as a speculative investment. The EVFL Customer's Agreement expressly required
19 an account holder to specially instruct EVLF in writing and receive confirmation for any
20 order placed for actual delivery. EVLF reserved the right to determine the time and place of
21 such delivery at its discretion. Orders placed without such instruction and confirmation were
22 deemed not for delivery.¹

¹ *Hearing Exhibit ("Exh.") S-161*. Indeed, the hearing record reflects that counsel for Respondents except

1 EVFL's preprinted "Customer's Agreement for Trading in Spot Currencies (FOREX)"
2 ("EVFL Agreement") was executed by investors "in consideration of EVF agreeing to accept
3 customer to open and/or continue to maintain an account or accounts, for trading in Spot Currencies
4 (FOREX) (hereinafter called "Investment")." *Exhs. S-54, S-55, S-56, S-57, S-58, S-59, S-60.*
5 Paragraph 1 of this agreement provided in part that EVFL "is hereby requested and authorized by
6 customer to act as broker or as agent or as principal to execute customer's Investment order/s. EVF
7 is authorized to take the opposite position to customer's order's on EVF's own account." *Id.*
8 Moreover, the "Addendum to Customer's Agreement" declared that the EVFL Agreement is
9 governed by the law of the state of Arizona. *Id.*

10 **B. Non-registration of Commodity Investment Contract Security**

11 All Respondents except Simmons have stipulated to the fact that the EVFL Forex accounts
12 offered or sold through FISC were never registered as securities under the SAA. *Exh. S-161.*
13 Respondent Simmons has not contested the allegation that these accounts were unregistered
14 securities under the SAA. No Respondent has raised any affirmative defense of exemption from
15 registration under the SAA.

16 **C. Respondent Offerors and/or Sellers**

17 The unlawful offer or sale of unregistered securities within or from Arizona encompasses
18 more than just face-to-face solicitation or sale by a seller. Under the recognized doctrine of
19 participant liability, a person violates A.R.S. § 44-1841(A) who is directly responsible for the
20 distribution of unregistered securities by conduct that is both necessary to and a substantial factor in
21 the unlawful transaction. *See S.E.C. v. Rogers*, 790 F.2d 1450, 1456 (9th Cir. 1986); *In the Matter of*
22 *the Offering of Securities by: Lost Dutchman Investments, Inc. et al.*, Arizona Corporation
23 Commission Decision No. 58259 (April 8, 1993), pp. 13-14; *In the Matter of the Offering of*
24 *Securities by: Terry L. Barrett et al.*, Arizona Corporation Commission Decision No. 58187

25
26 Simmons apparently did not contest that the EVFL trading accounts at issue in this matter were commodity
investment contract securities under the SAA. *Hearing Transcript ("H.T."), pp. 3156, 3158.* Respondent Simmons
has not contested the allegation that these accounts are commodity investment contracts.

1 (February 4, 1993), pp. 10-11; *In the Matter of the Offering of Securities By: The Woodington*
2 *Group, Inc. et al.*, Arizona Corporation Commission Decision No. 58113 (December 10, 1992), pp.
3 8-9; *In the Matter of the Offering of Securities by: American Microtel, Inc. et al.*, Arizona
4 Corporation Commission Decision No. 58088 (December 9, 1992), p. 17. Conduct necessary to the
5 unlawful transaction requires participation that is a "but for" cause of such transactions. *Rogers*, 790
6 F.2d at 1456; *Haberman v. Public Power Supply System*, 109 Wash. 2d 107, 130, 744 P.2d 1032,
7 1051 (1987), *appeal dismissed sub nom. American Express Travel Related Services Co. v.*
8 *Washington Public Power System*, 488 U.S. 805 (1988); *Lost Dutchman Investments*, pp. 13-14. To
9 be a substantial factor in the transaction requires participation that is more than *de minimis*. *Rogers*,
10 790 F.2d at 1456; *Lost Dutchman Investments*, pp. 13-14. No showing of direct contact between the
11 participant and the offerees is required to impose liability. *S.E.C. v. Holschuh*, 694 F.2d 130, 140 (7th
12 Cir. 1982); *Lost Dutchman Investments*, p. 14.

13 1. FISC

14 All Respondents except Simmons have essentially stipulated that FISC offered and sold
15 EVFL Forex accounts.² Respondent Simmons has not contested this fact. In their no-action letter
16 request to the Division dated August 23, 1996, FISC and EVFL represented that FISC will solicit
17 and obtain customers for EVFL. *H.T.*, pp. 1507-09; *Exh. S-61*, pp. 2-3. Tam admitted that FISC
18 "provide a service to handling the investment product that Eastern Vanguard offer. Also that we
19 handle the service of paper works and execute transaction of the orders. In return that we receive
20 compensation from Eastern Vanguard." *Exh. S-37a*, p. 52. Tam told witness FISC employee Mary
21 Goss that FISC was a "branch office" of EVFL -- "like a McDonald's, kind of like a part of the
22 company but, you know, an individual location." *H.T.*, pp. 1707-08, 1758. FISC's Better Business

23
24 ² "The leveraged trading accounts *offered or sold* by EVFL *through FISC* were promoted as a speculative
25 investment. " *Exh. S-161*, para. 18. (Italics added.) "The leveraged foreign currency trading accounts *offered or sold*
26 by EVFL *through FISC* were never registered as securities under the Securities Act of Arizona." *Exh. S-161*, para.
19. (Italics added.) Tam admitted that FISC acted as servicing agent for EVFL, *Exh. S-37a*, p. 51, and the December
17, 1997 "Amendment to Agreement" terminating FISC's selling relationship with EVFL stated that: "FISC will no
longer serve as a servicing agent or in any capacity for Eastern Vanguard and has no authority to act on behalf of
Eastern Vanguard." *Exh. S-73*.

1 Bureau application signed July 30, 1996 by Dionisio Meneses ("Dionisio") identified its business as
2 "foreign exchange broker" and listed EVFL as its parent company. *H.T.*, pp. 1495-96; *Exh. S-65*.
3 While employed as FISC marketing manager, Cho knew the accounts opened at FISC were in the
4 name of EVFL. *Exh. S-35a*, p. 96.

5 FISC opened for business in April 1996, *Exh. S-37a*, p. 33, with Dionisio as its first
6 marketing manager. *H.T.*, p. 1705; *Exh. S-37a*, pp. 26-28. Dionisio left FISC in November 1996,
7 *Exh. S-37a*, p. 28, and Cho became FISC marketing manager at the beginning of January, 1997,
8 *Exhs. S-35a*, pp. 12-14; *S-37a*, pp. 29-31, until he left FISC on October 31, 1997. *Exh. S-35a*, p. 13.
9 Simmons replaced him as marketing manager until the FISC office was closed on December 18,
10 1997. *H.T.*, pp. 560, 562, 2936; *Exh. S-36a*, pp. 13,35.

11 According to Tam, FISC started on April 1996 with no customers or traders. *Exh. S-37a*, pp.
12 33, 34.

13 Q. How did it go about obtaining customers?

14 A. We have many form -- first of all, we have --we train the traders. We advertising,
15 hire traders, and we give them training, approximately two months. And then they will make
16 telephone calls and so on so forth. And then we have hire -- in 1996, we hire some
17 telemarketer to make calls and I believe we buying lease to make telephone calls. And we
18 have people that make phone calls in office introducing our service.

19 *Exh. S-37a*, p. 34. Dionisio's job "was to train the traders and help them to find clients." *H.T.*,
20 p. 1705. FISC training classes for traders included instruction on how to recruit customers. *H.T.*, p.
21 1720; *Exh. S-36a*, p. 33. All Respondents except Simmons stipulated that FISC also engaged in the
22 telemarketing of trading accounts in 1996. *H.T.*, p. 1514. Six telemarketers were hired to work at
23 the FISC office for two months calling people from purchased lead lists. *H.T.*, p. 1738; *Exh. S-37a*,
24 pp. 38-40, 105. They worked from scripts, *H.T.*, p. 1737, and followed up calls by mailing two FISC
25 brochures, *Exhs. S-44* and *S-47*, and a cover letter to offerees. *H.T.*, pp. 1738-40. They were paid \$8
26 per hour and a percentage of each trade in accounts opened from them. *H.T.*, p. 1727. The
telemarketing began in late July and continued into September. *H.T.*, pp. 1725, 1743. During just the
four weeks between July 22nd and August 21st that year, 3,717 local and 244 long distance calls
were made from multiple phone lines at the FISC office. *H.T.*, pp. 1511, 1516-17; *Exh. S-51*. Most

1 of these calls lasted only a minute or less. *H.T.*, p. 1518.

2 Traders were provided business cards with FISC's name and a "standard" introductory FISC
3 letter recommended by Cho. *H.T.*, pp. 2442-43, 2792, 2794, 2795; *Exh. S-99*. Traders were allowed
4 to compose and send letters using FISC's letterhead. *H.T.*, pp. 2496, 2792-94, 2976. Simmons gave
5 investor Al Davis an FISC business card showing his name above his title of "*Currency Trader*."
6 *H.T.*, p. 110; *Exh. S-87*. (Italics in original.) At least 21 EVFL commodity investment contract
7 securities were offered and sold within or from Arizona through FISC, *Exh. S-138*, in violation of
8 A.R.S. § 44-1841.

9 **2. EVFL**

10 All Respondents except Simmons have essentially stipulated that EVFL offered and sold the
11 Forex accounts at issue in this matter.³ *Exh. S-65*. Respondent Simmons has not contested this fact.
12 FISC traders obtained clients for EVFL. *Exh. S-37a*, p. 78. While employed as FISC marketing
13 manager, Cho knew the accounts opened at FISC were in the name of EVFL. *Exh. S-35a*, p. 96. The
14 EVFL Customer Agreements admitted into evidence were the account-opening documents for
15 investors. *Exhs. S-37a*, pp. 50-51, 86; *S-43*; *S-54*; *S-55*; *S-56*; *S-57*; *S-58*; *S-59*; *S-60*. Tam admitted
16 that the Customer Agreements to be executed by clients were received by FISC with the EVFL
17 signature block already signed by an EVFL authorized person. *Exh. S-37a*, p. 54-55. Customers
18 opening accounts were to invest by checks payable to EVFL that were directly deposited by FISC to
19 an EVFL account at Citibank in San Francisco. *Exh. S-37a*, pp. 73-74. Thereafter, FISC prepared
20 and mailed EVFL account statements to investors. *H.T.*, pp. 1709-11. Simmons believed that EVFL
21 owned FISC. *Exh. S-36a*, p. 119.

22 By written agreement between FISC and EVLF dated January 1, 1997, EVFL undertook to
23

24
25 ³ "The leveraged trading accounts *offered or sold by EVFL* through FISC were promoted as a speculative
26 investment. " *Exh. S-161*, para. 18. (Italics added.) "The leveraged foreign currency trading accounts *offered or sold by EVFL* through FISC were never registered as securities under the Securities Act of Arizona." *Exh. S-161*, para. 19. (Italics added.)

1 pay FISC \$20,000 monthly plus \$50 per position closed in return for FISC providing "adequate
2 facilities," telephone and "communications equipment," and "training courses as well as training
3 facilities" for EVFL "employees." FISC was also to receive and distribute EVFL funds as directed
4 for commission payments to EVFL "employees." EVFL was "responsible for all taxes, and
5 withholdings, and must comply with all local, state and federal regulations." Moreover, FISC was to
6 provide "reasonable advertisements" for EVFL's "business" and "financial market information
7 related to" EVFL's "business." *H.T., pp. 1527-29.; Exh. S-73.* The contract also provided that:

8 THIS AGREEMENT and any disputes arising hereunder shall be interpreted and
9 construed under, and be governed by, the local, internal laws of the State of Arizona as such
10 laws are applied to any act or agreement entered into in Arizona with a Arizona corporation
11 and performed entirely within Arizona, and not conflict the laws of the State of Arizona.

12 *Exh. S-73.* At least 21 EVFL commodity investment contract securities were offered and
13 sold within or from Arizona through FISC, *Exh. S-138*, in violation of A.R.S. § 44-1841.

14 **3. Simmons**

15 Simmons personally sold and later managed sales of EVFL trading account securities
16 through FISC. He entered an FISC trader training class in January 1997 after an interview with Cho.
17 *Exhs. S-35a, p. 51; S-36a, pp. 28-29.* Cho helped him learn FISC trading procedures and assisted
18 him with clients. *Exh. S-35a, pp. 52-53.* He was employed by FISC as assistant marketing manager
19 to Cho either in April 1997, *Exhs. S-36a, p.19, S-37a, p. 31*, or on June 1, 1997. *Exh. S-36a, p. 20.*
20 As assistant manager, he took all his instructions from Cho. *Exh. S-36a, pp. 19-20.* The job duties
21 were to "assist department manager with everything basically from interviewing, training, and
22 monitoring the trainees to make sure that they are monitoring the market and to report to department
23 manager." *Exh. S-35a, p. 47.* His compensation was a \$750 monthly salary and an "override" of \$1
24 per position closed by any trader under his supervision. *Exh. S-36a, pp. 20-21.* He replaced Cho as
25 marketing department manager for FISC on November 1, 1997. *Exh. S-36a, pp. 13, 35.* As sales
26 manager, his compensation was a \$1,200 monthly salary and an "override" of \$1 per position closed
by any trader in the office. *Exh. S-36a, pp. 13-14.* His managerial duties included talking with

1 traders about the best way to do marketing and presiding over new account signing and the receipt
2 of investor funds. *Exh. S-36a, pp. 15, 91-92.* At the same time he acted as a trader for his own
3 clients. *Exh. S-36a, p. 16.* Simmons personally offered and sold EVFL accounts to Al Davis,⁴ F.
4 Dean Davis, Michael Noriega and Van Shumway. *Exh. S-36a, pp. 59, 107.* In his later job as FISC
5 marketing manager, Simmons participated in the sale of EVFL trading accounts through FISC to
6 two other investors, Chad Lares and Peter Baker. *Exh. S-138.* Both directly and as a responsible
7 participant, Simmons offered and sold EVFL commodity investment contract securities within or
8 from Arizona in violation of A.R.S. § 44-1841.

9 **4. Cho**

10 Cho also personally sold as well as managed sales of EVFL trading account securities
11 through FISC. He personally sold EVFL trading accounts to two investors through FISC, *H.T., p.*
12 *1319-20, 1329, Exh. S-35a, pp. 68-69,* and participated while marketing manager in the sale of
13 accounts to sixteen other investors.⁵ *Exh. S-138.*

14 Cho admitted he was employed by FISC as its marketing manager from January through
15 October 1997. *Exhs. S-35a, p. 13; S-161, para. 8.* He testified that this person "is the one who's
16 making decisions," *H.T., p. 3021,* and that his job was "to generate business" for FISC. *H.T., p.*
17 *2156.* His compensation from FISC for this employment included a \$2,000 monthly salary and a
18 monthly "commission package" composed of a cut of new investor funds received by FISC, ranging
19 from 0.5% of deposits to 0.75% if in excess of \$75,000 that month,⁶ and a \$1 to \$2 "override" for
20 each trading position closed that month in accounts traded through FISC. He also received a \$400
21 bonus if investor deposits reached \$75,000 and 100 trading positions closed in one month. *Exh. S-*
22 *335a, pp. 26-30.* During the ten months he managed marketing for FISC in 1997, he was paid

23
24 ⁴ The promotional material he provided to Al Davis to induce him to invest is included in admitted Exh. S-
25 36b as exhibits 5, 6, 7 and 8 therein, which were separately admitted as Exhs. S-83, S-84, S-85, S-86 respectively.

26 ⁵ K. Schnad, E. Benson, Bahamas/BSI, D. & M. Davis, S. Becker, B. Stamford, A. & D. Davis, W. Thomas,
M. Noriega, M. Barry, L. Min, V. & R. Shumway, B. Shalz, J. Nagorny, W. Scott and M. Unlucomert. *Exh. S-138.*

⁶ Cho testified that these investor deposits were "what we call a margin in, money coming in." *H.T., p.*
2156.

1 \$16,000 to \$17,000 from this "commission package" alone. *H.T.*, pp. 2772-73. Cho admitted that
2 when F. Dean and Melba Davis invested \$50,000 in their FISC account, he received his "margin in"
3 percentage of this investment as part of his compensation. *H.T.*, p. 2837-38.

4 Cho was responsible for hiring and training traders. *Exh. S-35a*, p. 14. He placed the FISC
5 newspaper ads that advertised for foreign currency trader applicants. *Exh. S-36a*, p. 97. After the
6 January 1997 training class concluded, Cho taught two later classes and participated in another. *Exh.*
7 *S-36a*, p. 94. FISC training classes included instruction on how to recruit clients. *Exh. S-36a*, p. 33.
8 "How to talk to potential clients. Basically introducing the product which is currency market to the
9 clients, introducing the product, the company," Cho testified. *H.T.*, p. 2189. He conducted this
10 marketing session. *H.T.*, p. 2778. He admitted that "the people were there to be a currency trader and
11 they were selling their product. They were sending brochures, talking to potential clients. That's
12 marketing to me." *H.T.*, p. 2188. He recommended trainees use the FISC brochures and a "standard"
13 FISC introductory letter to solicit investors. *H.T.*, pp. 2193-94, 2794; *Exh. S-99*. He reviewed the
14 EVFL Customer Agreement with the classes. *H.T.*, p. 2778; *Exh. S-36a*, p. 34. During the mock
15 trading portion of training, Cho asked trainees about potential clients. *H.T.*, p. 2804.

16 Cho supervised all the traders after they finished training and assisted them in talking with
17 their clients. *Exhs. S-35a*, p.14; *S-36a*, p. 21; *S-37a*, p.31. He "told the trainees that if they needed
18 assistance in talking to the clients, if they had problem talking to clients or if the clients had
19 questions, to bring them in and I will be available to speak with them. And I did say I would help
20 close the account, yes. " *H.T.*, p. 2900. In late February, he purchased \$500 worth of leads for use in
21 the office by trainees or traders. *H.T.*, p. 2773-74. There were a lot of names. *H.T.*, p. 2775. He told
22 the traders about the leads and invited them to use them. *H.T.*, p.2775. He passed them out to several
23 people, including Dan Hoesch. *H.T.*, p.2775. He would pass out five to ten sheets, each with 20 or
24 30 names on it. *H.T.*, pp. 2775-76. At a party with the traders in the late summer of 1997, he queried
25 each trader about investor recruitment. *H.T.*, pp. 2804-08.

26 In January 1997, Cho interviewed Simmons for FISC training. *H.T.*, pp. 2197-98. Cho

1 taught the class Simmons was in. *H.T.*, p. 2199. Cho hired Simmons as assistant marketing manager,
2 *Exh. S-36a*, p. 20, after recommending him to Tam and getting Tam's approval. *H.T.*, p. 2872. Cho
3 also specifically trained Simmons as his assistant, *H.T.*, p. 2978, and gave him "specific instructions
4 not to make any decisions about anything regarding the trainees. That I was the one who was
5 making those decisions." *H.T.*, pp. 2977-78. Simmons reported to him. *H.T.*, pp. 3021-22.

6 Cho was present when the Davises and the Shumways visited Simmons at the FISC office.
7 *H.T.*, pp. 2201, 2828, 3009; *Exh. S-36a*, p. 87. He was also present with Simmons when Al Davis,⁷
8 his parents F. Dean and Melba Davis,⁸ the Shumways⁹ and Michael Noriega¹⁰ came to the office to
9 open their accounts. *H.T.*, pp. 2204, 2207, 2825, 2833, 3009, 3013-14; *Exhs. S-35a*, p. 53; *S-36a*, p.
10 88-89. During such visits, Cho would talk with clients, explain procedures and "reiterate, mostly,
11 what they already know about. A little about Forex." *H.T.*, p. 2207; *Exh. S-36a*, p. 88. Cho's duties
12 included presiding over the signing of new Customer Agreements and the receipt of investor funds.
13 *Exh. S-36a*, p. 92. He took the signed Customer Agreement and initial deposit check from Alan and
14 Debbie Davis and from Michael Noriega when they opened their account. *H.T.*, pp. 138, 1211-12.
15 He also took the initial deposit check from Dean and Melba Davis. *H.T.*, p. 978. Most of the time he
16 saw the investor checks. *H.T.*, p. 3047. He recalled meeting investors Schnad and Min and taking
17 their deposit checks. *H.T.*, p. 3044. He admitted he probably saw the checks for investors Becker,
18 Thomas and Unlucomert. *H.T.*, pp. 3047-48, 3049. He also admitted he might have taken investor
19 Benson's deposit check. *H.T.*, p. 3045.

20 As FISC marketing manager, Cho's participation in its offer and sale of EVFL securities
21

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23 ⁷ Cho admitted he spoke with Alan and Debbie Davis for 10 or 15 minutes the day they opened their
account, *H.T.*, p. 2205.

24 ⁸ Cho admitted he gave Dean and Melba Davis their copies of the executed customer agreements and spoke
with them for five to seven minutes. Alan and Debbie Davis were also present. *H.T.*, p. 2208.

25 ⁹ Cho admitted he met the Shumways and spoke with them "very briefly". *H.T.*, p. 2212. Before they
invested, Cho testified he spoke by telephone for five to ten minutes with Van Shumway about Forex investing.
26 *H.T.*, p. 2214.

¹⁰ Cho admitted he spoke with Noriega for "less than five minutes" after he signed the customer agreement.
H.T., p. 2215.

1 was more than *de minimis*. But for his participation, the 16 investments made during his tenure as
2 manager would not have occurred. Both directly and as a responsible participant, Cho offered and
3 sold EVFL commodity investment contract securities within or from Arizona in violation of A.R.S.
4 § 44-1841.

5 **III.**
6 **TRANSACTIONS BY UNREGISTERED DEALERS OR SALESMEN**

7 The Division alleged that FISC, EVFL, Simmons and Cho violated A.R.S. § 44-1842 by
8 acting as securities dealers or salesmen while unregistered under the SAA. All Respondents except
9 Simmons have stipulated that FISC, EVFL, Simmons and Cho were never so registered. *Exh. S-161*
10 *para. 20*. Simmons has not contested this fact. Moreover, Simmons admitted on December 8, 1997
11 that he was never registered anywhere to sell securities, *Exh. S-36a, p. 25*, and an uncontested
12 Division certificate of non-registration for him was admitted into evidence pursuant to A.R.S. § 44-
13 2034. *Exh. S-141*.

14 **IV.**
15 **FRAUD IN CONNECTION WITH THE OFFER OR SALE OF SECURITIES**

16 **A. Primary Liability Under A.R.S. § 44-1991**

17 The Division alleged that in connection with the offer or sale of EVFL securities, FISC,
18 EVFL, K. David Sharma ("Sharma"), Simmons, Cho, To Fai Cheng ("Cheng"), Jean Yuen
19 ("Yuen"), Y & T Inc. dba Tokyo International Investment Ltd. ("Tokyo") and Wing Ming Tam
20 ("Tam") (collectively the "primary Respondents") violated A.R.S. § 44-1991 by directly or
21 indirectly making untrue statements and misleading omissions of material fact, and by directly or
22 indirectly engaging in transactions, practices or courses of business which operated or would
23 operate as a fraud or deceit. Securities fraud may be proven by *any one* of these acts. *Hernandez*
24 *v. Superior Court*, 179 Ariz. 515, 880 P.2d 735 (Ct. App. 1994) (*italics in original*). Simmons has
25 not contested this allegation.

26 A primary violation of A.R.S. § 44-1991 can be either direct or indirect. It is now well-

1 settled in Arizona that *indirectly* violating A.R.S. § 44-1991 is not to be narrowly interpreted. In
2 *Barnes v. Vozack*, 24 Ariz. App. 542, 540 P.2d 161 (1975) ("*Vozack I*"), *vacated*, 113 Ariz. 269,
3 550 P.2d 1070 (1976) ("*Vozack II*"), Division Two of the Court of Appeals reversed a trial court
4 judgment of joint and several liability under A.R.S. § 44-1991(2) against three individual
5 defendants, Barnes, Tash and Herzberg. These defendants had formed Commercial Management
6 Corporation ("CMC") and were its sole shareholders, directors and officers. *Vozack I*, 24 Ariz.
7 App. at 544, 540 P.2d at 163. Two other individuals named Sitzler and Laurie later organized
8 another company called Budget Controls, Inc. ("Budget") that Sitzler was to run. Laurie, the sole
9 shareholder of Budget (but under the control of Barnes, Tash and Herzberg), initially was to
10 release stock in blocks to Sitzler as he brought in clients. Tash helped Sitzler run Budget, while he,
11 Barnes and Herzberg paid the Budget organizational expenses and provided operating capital in
12 return for a share of future profits. When it became apparent Budget has insufficient capital to
13 operate successfully, Barnes, Tash and Herzberg later lent more money to Budget through CMC
14 and contracted for CMC to provide management services to Budget for \$3,000 a month. *Id.*

15 Continuing financial difficulties led Budget to issue and sell unregistered stock pursuant
16 to a special exemption order obtained from the Commission. *Id.* Barnes, Tash and Herzberg
17 increased their involvement in Budget and Tash assumed complete managerial control. In
18 connection with his solicitation and sale of \$17,000 of this stock to Vozack, an elderly widow, a
19 Budget employee named Hassett told her untrue statements of material fact. Budget later merged
20 with CMC and Vozack eventually sued Budget, CMC, Hassett, Barnes, Tash and Herzberg to
21 recover her investment.¹¹ *Id.* at 544-545, at 163-165.

22 The Court of Appeals concluded that the evidence was insufficient to prove that Barnes,
23 Tash and Herzberg participated in Hassett's misrepresentations. *Id.* at 546, at 165. Their
24

25
26 ¹¹ The trial court rendered a joint and several judgment against all defendants for the amounts demanded by
Vozack. *Vozack I*, 24 Ariz. App. at 545, 540 P.2d at 164. Barnes, Tash and Herzberg appealed only as to themselves.
Id. The portion of the judgment against Budget, CMC and Hassett was apparently not appealed and became final.

1 bankrolling of Budget and control over the stock held by Laurie "show at most that as a general
2 proposition appellants were heavily involved in the operation of Budget Controls." *Id.* at 546-
3 547, at 165-166.

4 Hassett, who presumably could have shed much light on the question of whether
5 appellants participated with him in defrauding appellee, did not testify. Absent his
6 testimony, there is no evidence that appellants directly or indirectly participated in any
7 specific act of fraud. There is also nothing to show that appellants personally employed
8 Hassett or that Hassett was anything but the employee of Budget controls. Finally, there is
9 no evidence that appellants authorized Hassett's fraudulent acts. On this record we must
10 conclude that appellants cannot be held liable for Hassett's misrepresentations to appellee.

11 *Id.* at 547, at 166. Our supreme court granted review "In Banc" as to, *inter alia*, whether
12 the trial court evidence was sufficient to show that Barnes, Tash and Herzberg participated in the
13 fraud. *Vozack II*, 113 Ariz. at 270, 271, 550 P.2d at 1071, 1072. Opining that the trial testimony
14 "was certainly sufficient from which the court could find that Hassett *directly* violated A.R.S.
15 §44-1991 and was guilty of statutory fraud," the court addressed whether Barnes, Tash and
16 Herzberg "*indirectly* violated the statute." *Id.* at 273, at 1074. (Italics added.) Deposition
17 testimony by Barnes was cited in which he admitted "a hundred percent" management over
18 Laurie when Budget applied to the Commission for its special exemption order. *Id.* Tash's trial
19 testimony was cited wherein he admitted that after CMC contracted to manage Budget, "we were
20 not only running the company" but also "putting up money to fund it." Moreover, Budget
21 "officed" with CMC "to act as their place of records" and "answering service." *Id.* Testimony by
22 Herzberg was also cited that prior to the sales of stock to Vozack, CMC contracted to provide
23 management services to Budget. *Id.* at 273-274, at 1074-1075.

24 The supreme court said these "three defendants all admitted by this testimony that they
25 were, in fact running Budget Control" and it concluded that "the evidence¹² was sufficient from
26 which the trial court could find that the three defendants *indirectly* fraudulently sold stock to

¹² Vozack had previously invested \$17,000 in a separate limited partnership managed by CMC, but withdrew her investment before the Commission authorized Budget to issue and sell its stock. *Vozack II*, 113 Ariz. at 270, 550 P.2d at 1071. The supreme court noted it "appears to be more than a coincidence" that Hassett solicited Vozack to buy the Budget stock after Vozack received back her limited partnership investment. *Id.* at 274, at 1075.

1 Vozack contrary to A.R.S. § 44-1991." *Id.* at 274, at 1075. (Italics added.) *Vozack II* vacated
2 *Vozack I* and affirmed the original trial court judgment against the three defendants. *Id.* at 275, at
3 1076.

4 *Vozack II* established that the individual principals of a corporation (CMC) that managed
5 a second corporation (Budget) were indirectly but primarily liable for untrue statements uttered
6 to an offeree in violation of A.R.S. § 44-1991 by a securities salesman (Hassett) for the second
7 corporation.¹³

8 **1. Untrue Statements and Misleading Omissions of Material Fact**

9 The elements of securities fraud under A. R. S. § 1991(2) are as follows:

- 10 1. in connection with a transaction or transactions;
11 2. within or from Arizona;
12 2. involving an offer to sell or buy securities, or their sale or purchase;
13 3. to directly *or indirectly*;
14 4 make any untrue statement of material fact;
15 5. or omit to state any material fact necessary in order to make the statements made, in light
16 of the circumstances under which they were made, not misleading.

17 Materiality is a showing of substantial likelihood that, under all the circumstances, the
18 misstated or "omitted fact would have assumed actual significance in the deliberations" of a
19 reasonable buyer. *Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131,
20 1136 (1986), citing *Rose v. Dobras*, 128 Ariz. 209, 214, 624 P.2d 887, 892 (App. 1981), *quoting*
21 *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976). Under
22
23

24 ¹³ In another case affirming the securities fraud convictions of "a principal who indirectly made an untrue
25 statement of a material fact" in violation of the Colorado Securities Act, the Colorado Supreme Court opined that
26 where "there is evidence, such as is present in this case, of a *general mode of doing business* over which the
defendant has strong overall control, it is not difficult to find that the defendant *indirectly* makes those
representations which are conveyed by his sales representatives." *People v. Blair*, 195 Colo. 462, 463, 579 P.2d
1133, 1144 (1978) (En Banc). (Italics added.)

1 this objective test, there is no need to investigate whether an omission or misstatement was
2 actually significant to a particular buyer.

3 The affirmative duty not to mislead potential investors in any way places a heavy burden
4 on the offeror and removes the burden of investigation from the investor who is not required to
5 act with due diligence. *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136. A misrepresentation or
6 omission of a material fact in the offer and sale of a security is actionable even though it may be
7 unintended or the falsity or misleading character of the statement may be unknown. *Scienter* or
8 guilty knowledge is not an element of a civil violation of A. R. S. § 44-1991(2). *State v.*
9 *Gunnison*, 127 Ariz. 110, 113, 618 P.2d 604, 607 (1980) (In Banc).¹⁴ A seller of securities is
10 strictly liable for the misrepresentations or omissions he makes. *Rose v. Dobras*, 128 Ariz. at
11 214, 624 P.2d at 892.

12 Further, if the omissions or nondisclosures meet the standards of materiality to a reasonable
13 investor, causation and reliance can be assumed. *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136,
14 quoting *Harmsen v. Smith*, 693 F.2d 932, 946 (9th Cir. 1982). Additionally, there is no requirement
15 to show that investors relied on the misrepresentations or omissions, *Rose*, 128 Ariz. at 214, 624
16 P.2d at 892, or that the misrepresentations or omissions caused injury to the investors, *Trimble*, 152
17 Ariz. at 553, 733 P.2d at 1136.

18 The Division alleged the following specific acts by which the primary Respondents violated
19 A. R. S. § 1991(2) with untrue statements and misleading omissions of material fact.

20 **a. Untrue Statement of Salesmen Trading Qualifications**

21 The Division alleged that the primary Respondents specifically made untrue statements that
22

23 ¹⁴ In so interpreting A.R.S. § 44-1991(2), the Supreme Court of Arizona identified §17(a) of the federal
24 Securities Act of 1933 ("1933 Act") as the counterpart to A.R.S. § 44-1991, then followed the corresponding federal
25 interpretation of §17(a)(2) in *Aaron v. Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945, 64
26 L.Ed.2d 611 (1980). *Gunnison*, 127 Ariz. at 112-113, 618 P.2d at 606-607. Our supreme court declared that although
it was "not bound by the interpretation placed by the United States Supreme Court on the federal statute, it is helpful,
for consistency in the application of the law, to be harmonious with the United States Supreme Court. Unless there
is a good reason for deviating from the United States Supreme Court's interpretation, we will follow the reasoning of
that court in interpreting sections of our statutes which are identical or similar to federal securities statutes." *Id.*

1 EVFL or FISC salesmen were professional currency traders able to make sound investment
2 decisions on behalf of investors, while in fact such salesmen had insufficient training and experience
3 in Forex-related trading and made unsound investment decisions that caused substantial losses by
4 investors.

5 ***The Story Provided to Investors***

6 Offerees were solicited to invest in EVFL trading accounts managed by trained, professional
7 currency traders at FISC who made profits for investors through sound investment decisions. The
8 FISC brochure entitled "Foreign Exchange Services" declared under its "Company Profile" heading
9 that:

10 Assembled in Phoenix office is a group of professional spot currency traders
11 committed to offering the highest quality personal service to clients. Associates are provided
12 with the latest information in the world currency market, both fundamentally and
13 technically. Traders are further supported with state-of-the-art computerized analytical
14 systems and technology. We provide seminars assuring that associates [sic] are kept well
15 abreast of the latest trading tools and techniques, both in theory and application.

16 *Exh. S-44. Associates means traders in this brochure. Exh. S-36a, pp. 65-66. Under "Foreign*
17 *currency Trading," the brochure further declared: "Forex Investment Services Corp. research team*
18 *also provides its traders and clients with in-depth fundamental and technical analysis. With this*
19 *wealth of experience and knowledge, Forex Investment Services Corp.'s traders have the discipline*
20 *and ability to make sound investment decisions." Exh. S-44. (Italics added.) Tam and Cho testified*
21 *that this brochure, as well as a trifold FISC brochure admitted as Exh. S-47, were made available to*
22 *traders to give to prospective investors. Exhs. S-35a, pp. 70-71, 74; S-37a, pp. 101-102. These*
23 *materials were also given to FISC trainees for marketing. H.T., pp. 1779-80; Exh. S-35a, p. 73. Both*
24 *Cho and Simmons gave these to their investor clients at FISC. Exhs. S-35a, p. 72; S-36a, pp. 60-61,*
25 *63. Prospective investors received these brochures and a letter summarizing them, along with the*
26 *EVFL Customer Agreement. Exh. S-35a, p. 74.*

27 The "standard" FISC introductory letter recommended by Cho to trainees for use in
28 soliciting investors, *H.T., pp. 2794*, boasted that a "managed currency trading program can provide
29 a high return relative to traditional investment vehicles that have some degree of risk involved." *Exh.*

1 S-99. Listing "Potential High Returns" first under "Benefits" of Forex trading, it declared that "the
2 individual investor can now take advantage of this exciting and lucrative market. Increase your
3 investment returns by investing in the Foreign Currency market!" *Exh. S-99*. There is no mention of
4 risk of loss.

5 Simmons said the focus on his discussions with prospective clients was making a profit
6 rather than preservation of capital. *Exh. S-36a, pp. 70-71*. He acknowledged this focus was
7 consistent with information on the fifth page of the FISC brochure admitted as *Exh. S-44*:

8 Q. It states, "Foreign Currency Investment: A Profitable Alternative," is that correct?

9 MR. YOUTZ: He's reading from here.

THE WITNESS: Oh, okay. Yes.

10 Q. (BY MR. KNOPS) And that would be in line with the focus that you have
described on investing in these accounts as yielding a profit or a return on investment, rather
than merely preserving capital?

11 A. Yes.

12 Q. At the bottom of that section, which would be the second paragraph down, the last
sentence states, "Foreign currency trading has inherent advantages over traditional forms of
investment," is that correct?

13 A. Yes.

14 Q. Would you agree with that?

A. Yes.

15 Q. And have you presented that position to prospective clients?

A. Yes.

16 Q. And then the next section, "High Rate of Return," beneath that sentence, do you see
that?

A. Yes, I do.

17 Q. The last and second sentence of that subsection states that "100 per cent return on
investment in a given year is not uncommon due to the volatility of the spot market." Do you
see that?

18 A. Yes I do.

19 Q. Would you agree with that statement?

A. It's possible. I haven't personally done it, so I can't say.

20 Q. When you provide this document to any prospective clients, do you add a disclaimer
orally to this document that --

21 A. No, I don't.

22 Q. -- in regard to this statement?

A. No.

23 Q. the letter that you describe that you provide to a prospective client, is that provided to
them at the time that you're giving them the brochures that are reproduced here as Exhibits 1
and 2?¹⁵

24 A. Yes.

25
26 ¹⁵ These two numbered exhibits are included in admitted *Exh. S-36b* and were separately admitted as *Exhs. S-47* and *S-44* respectively.

1 Q. And do I understand you correctly that that letter does not contain anything
substantially different from what's contained in those two exhibits.

2 A. That's correct.

3 *Exh. S-365a, pp. 71-73.* The key to selling prospective investors on the profitability of the
4 EVFL trading accounts was pitching the trading proficiency of the FISC trader/salesman. Cho
5 admitted that Joseph Saxon, one of his two personal clients a FISC, "would not have opened an
6 account if he thought that I was a terrible trader." *H.T., p. 2902.* Simmons candidly described the
7 promotional pitches that he learned at FISC:

8 Q. Did you ever tell any prospective client that they could make 3 to 5 percent monthly
return from trading in an FISC account.

9 A. Yes.

10 Q. And is that something that you told all prospective clients, or just one or two of
them?

11 A. Basically, all.

12 Q. And what was the basis for that statement?

13 A. From my understanding, when I went through my marketing courses, on average,
there's a good potential to make between 3 to 5 percent a month.

14 Q. When you said "your courses," did you mean the training at FISC?

15 A. Correct.

16 Q. So is it fair to say then that information that was provided during the training
indicated that 3 to 5 percent monthly return could be anticipated when trading in an FISC
Forex account?

17 A. Well, nothing was guaranteed to anyone. But with conservative trading, good
discipline, yes.

18 Q. Did you tell any of your prospective clients that they could double their investment
within two years?

19 A. Again, going over the brochure with them, that's one of the things that it says in
there, so, yeah, when you're reading the brochure, unless you skip that part, right.

20 Q. So that kind of estimate would have been based on information that you received in
the training or from the materials that you saw?

21 MR. YOUTZ: Objection, compound.

22 Go ahead.

23 THE WITNESS: Yes.

24 *Exh. S-36a, pp. 84-86.* To induce Al Davis to invest at FISC, Simmons claimed he had been
25 a commodities trader on the east coast, *H.T., p. 84*; that he traded his uncle's \$200,000 account at
26 FISC so it made \$15,000 monthly to send the uncle, *H.T., pp. 85, 99-100*; that he was trading his
own and his mother's account at FISC, *H.T., pp. 85, 100-101*; that he doubled his mother's account'
H.T., pp. 100-101; that seven out of ten trades he did were profitable, *H.T., pp. 101-02, Exh. S-36a,*
pp. 120-121; that Davis would make three to five percent a month and double his account every two

1 years, *H.T.*, p. 102; and that he placed a \$300 stop loss on every trade and never lost more than \$320
2 an a trade, *H.T.*, p. 102; *Exh. S-36a*, pp. 115, 120. Simmons also mailed items to Davis, including a
3 note intimating that he could make \$10,000 in one day, *H.T.*, pp. 108-09, *Exh. S-85*, and a printout
4 of Japanese Yen price movements for April 3, 1997, noting thereon that "this could have been a
5 20,000+ day for you." *H.T.*, p. 109; *Exhs. S-36a*, pp. 106-107; *S-36b*; *S-86*.

6 A key element in pitching trader proficiency during 1997 was promoting the cult of Cho as a
7 master trader. Simmons told Davis before he invested that Cho made \$20,000 monthly trading and
8 was "one of the best in the business." *H.T.*, p. 114. He also told him that Cho was brought from the
9 San Francisco office to "pick this office up" because of how well he did over there, *H.T.*, p. 418, and
10 that he fired 17 out of the 25 traders at FISC "because they wouldn't obey how he wanted the trading
11 practices done at the office there." *H.T.*, p. 115. Cho admitted that Joseph Saxon, one of his two
12 personal clients a FISC, "would not have opened an account if he thought that I was a terrible
13 trader." *H.T.*, p. 2902.

14 When Al Davis opened his account at the FISC office, Cho told him that he would make
15 three to five percent on it and double it in two years. *H.T.*, p. 139. Based on what he had been told,
16 Al Davis believed that Simmons and Cho were professional currency traders who could make sound
17 investment decisions on his behalf. *H.T.*, p. 417. Davis relayed all this information to his retired
18 parents, F. Dean and Melba Davis, who in turn relied on it to make their decision to invest through
19 FISC. *H.T.*, p. 743-44. When the elder Davises and Alan met with Simmons at the FISC office to
20 open their account, Simmons repeated that the account would earn three to five percent a month and
21 double in two years; that they could lose no more than \$300 per trade because of his use of stop loss
22 orders; and that seven of ten trades he did made money. *H.T.*, pp. 746, 747. They met Cho after they
23 executed the Customer Agreement, who "reiterated the 3 to 5 percent and double your money at that
24 time to them," and told them he would make sure their account was traded properly. *H.T.*, pp. 747-
25 48.

26 The story about the investor profits to be made from the sound decisions of trained FISC

1 professional traders was a fable.

2 *The Reality Inflicted on Investors*

3 The introductory rudiments of currency trading provided by the FISC training program
4 produced deplorably sad results. Employed at FISC from April until November 1996, witness Mary
5 Goss observed as a dealing clerk that trainees "all pretty much lost all of their money in the mock
6 trade." *H.T.*, pp. 1723-24. Other witnesses who had been trainees testified they lost money during
7 the mock trading portion of their training. *H.T.*, pp. 234-35 (*Scott*), 464-65 (*Nagorny*), 1798
8 (*Lawson*). Of the 21 EVFL investor accounts opened through FISC, all but two lost money. *Exh. S-*
9 *138*.

10 Tam admitted more client accounts at FISC lost money than made money. *Exh. S-37a*, p.
11 48. Simmons knew of only one trader who had made money for his client account. *Exh. S-36a*, pp.
12 68-69. He admitted he did not meet anybody through FISC who made a 3-5% monthly return from
13 Forex trading or who doubled their investment within two years. *Exh. S-36a*, p. 86. He had never
14 been a commodities trader. *Exh. S-36a*, pp. 10-11. He never traded in commodities futures or
15 options nor was ever registered to sell such products. *Exh. S-36a*, pp. 12, 26. Between 1986 and
16 1988, he invested in commodities like corn, wheat and cattle through a brokerage account, but
17 ceased after the end of 1988. *Exh. S-36a*, pp. 11-12. He had no background or experience in foreign
18 currency trading when he entered the FISC training class in January 1997. *Exh. S-36a*, p. 32. He
19 never traded any EVFL accounts for any family relative. *Exh. S-36a*, p. 60. He never managed an
20 account worth over \$200,000 belonging to his uncle in the Midwest. *Exh. S-36a*, p. 60. He never
21 handled investments of any kind for relatives. *Exh. S-36a*, p. 60. He admitted he knew of no blanket
22 stop loss or limit order, that a stop loss order can only be placed on a specific buy or sell order, and
23 that an order might not get executed in a volatile market. *Exh. S-36a*, p. 57. In a phone conversation
24 with investor Alan Davis on December 9, 1997, after Davis had closed his EVFL account, Simmons
25 admitted that stop loss orders "don't work. I found that, that out the hard way." *Exh. S-62*, p. 8.

26 Cho conceded that the following representations to Al Davis by Simmons were improper: "3

1 to 5 percent return; that to double the account in two years; 7 out of 10 trade were good; that limit
2 orders were supposed to be placed for all trades which would limit their losses to \$300; that James
3 had said that Eastern Vanguard was related to Vanguard mutual fund; like 17 traders were fired by
4 Michael; that he was trading his family's account, his uncle's account, that he was making some
5 return for them, good return for them; that James had told them that he's the one who send a client to
6 Security Division to complain." *H.T.*, pp. 2909-10.

7 The cult of Cho as a master trader was simply another fable. Cho had only seven or eight
8 investor clients before he was employed by Tokyo, *Exh. S-35a*, p. 66, and less than ten investors
9 while at Tokyo. *Exh. S-35a*, p. 66. He admitted that two thirds of these investors lost money, *H.T.*, p.
10 2973, and that most of his investors at Tokyo lost money. *Exh. S-35a*, p. 66. Both of his two
11 personal investor clients at FISC lost money. *Exh. S-35a*, p. 69. Young Choi, one of his personal
12 clients at FISC, *H.T.*, p. 3007, lost about three out of every four dollars he invested . *H.T.*, p. 2901;
13 *Exh. S-138*. He admitted it was "probably not" likely that a Forex investor could make a 3%-5%
14 monthly return from trading. *Exh. S-35a*, pp. 77-78. He did not know whether it was likely that an
15 average investor at FISC could double an investment within two years. *Exh. S-35a*, p. 78.

16 FISC trader Dan Hoesch did not disclose to offeree Barry when she invested that Kenneth
17 Schnad, Hoesch's only other client at FISC, had just lost his entire \$28,000 investment only a month
18 before. *H.T.*, pp. 2514-15; *Exh. S-138*. Barry invested \$20,000 and within four months Hoesch had
19 traded it down to \$92.71 when she closed her account. *H.T.*, pp. 2515-16; *Exh. S-138*. Cho knew
20 about the problems with these two accounts. *H.T.*, p. 2531. Hoesch admitted both investors were
21 angry about losing their funds. *H.T.*, pp. 2517-18. Hoesch nevertheless continued soliciting
22 investors. *H.T.*, p. 2518.

23 Trading account investors had no due diligence burden of investigation to ask for this
24 information. *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136. The primary Respondents had a
25 affirmative duty to disclose to their offerees the true material facts about the training, experience and
26 trading ability of FISC's traders and marketing staff. *See id.*

1 **b. Misleading Omission of Business Experience Information**

2 The Division alleged that the primary Respondents specifically failed to disclose the
3 business experience of EVFL and its principals. Cho said FISC trader trainees were told that "we do
4 business with Eastern Vanguard Forex Limited in Macau, and that they have other, they have other
5 offices that they do business with in the United States as well as other countries. That's about it."
6 *Exh. S-35a, p. 37.* If traders requested more information, he would provide them with the EVFL
7 "Company Profile" admitted as Exh. S-53 or a modified version he had prepared while at FISC.
8 *H.T., pp. 2880-2888.* These merely listed the names and titles of EVGL and EVGL officers or
9 directors. *Exh. S-53.* It was the only information about EVFL and its principals that FISC trader Dan
10 Hoesch provided to about 30 offerees he solicited. *H.T., pp. 2433, 2476.*

11 Witnesses Willis Scott, Al Davis, Melba Davis, Ruth Shumway, Michael Noriega and
12 Joseph Saxon testified that they were not provided with information about the business background
13 and experience of EVFL and its principals before they invested. *H.T., pp. 246-48, 417-18, 979,*
14 *1082, 1222-23, 1340.* Trader Bill Nagorny also testified that his investor father was not provided
15 with this information. *H.T., p. 488.*

16 Failure to disclose the business history of a commodity investment contract issuer and the
17 business backgrounds and experience in commodity investments of its principals is a misleading
18 omission of material fact. *See State ex rel. Corbin v. Goodrich*, 151 Ariz. 118, 126-127, 726 P.2d
19 215, 223-224 (Ct. App. 1986). Trading account investors had no due diligence burden of
20 investigation to ask for this information. *See Trimble*, 152 Ariz. at 553, 733 P.2d at 1136.

21 **c. Misleading Omission of Financial Condition Information**

22 The Division alleged that the primary Respondents specifically failed to disclose financial
23 statements reflecting the financial condition of EVFL. Failure to disclose the financial condition of a
24 commodity investment contract issuer is a misleading omission of material fact. *Goodrich*, 151 Ariz.
25 at 126-127, 726 P.2d at 223-224. Trading account investors had no due diligence burden of
26 investigation to ask for this information. *See Trimble*, 152 Ariz. at 553, 733 P.2d at 1136. Cho

1 testified that trader trainees at FISC were "never" provided with any financial information about
2 EVFL. *Exh. S-35a, p. 38*. Simmons admitted he did not know anything about the financial condition
3 of EVFL. *Exh. S-36a, p. 103*. FISC trader Dan Hoesch testified that he never had any EVFL
4 financial statements to provide the "close to 100 people" that he solicited to invest in 1996 and 1997.
5 *H.T., pp. 2438, 2475-76*. Investors Willis Scott, Al Davis, Melba Davis, Ruth Shumway, Michael
6 Noriega and Joseph Saxon testified that they never received any financial statements reflecting the
7 financial condition of EVFL. *H.T., pp. 248, 418, 979, 1082, 1223, 1340*. Trader Bill Nagorny also
8 testified that his investor father was not provided with this information. *H.T., p. 488*.

9 **d. Misleading Omission of Customer Order Execution Information**

10 The Division alleged that the primary Respondents specifically failed to disclose how
11 customer Forex orders were executed by EVFL. Tam admitted that all he knew about EVFL
12 execution of customer orders from FISC was "we place an order through Eastern Vanguard. And
13 Eastern Vanguard, I believe they place into other dealers, as well." *Exh. S-37a, p. 24*. He did not
14 know any other dealer. *Exh. S-37a, p. 26*. FISC dealing clerk Mary Goss was told in 1996 by
15 "[p]retty much everyone in the office" that after an FISC order was received in Macau "there was
16 someone in the pit, like Wall Street, something like that, who would be bidding for it or something,
17 like, to that effect." *H.T., pp. 1712-1713*. During his first day of training, Aaron Lawson was told by
18 Dionisio that investor orders were executed on an exchange in Macau where EVFL had a "seat."
19 *H.T., pp. 1783-84*. Cho was told by Tam that "the orders were generally passed to either banks or
20 Manila Commodity Exchange or to other firms. A lot of time, he says that since Eastern Vanguard is
21 doing business with many offices around the world, if there's a sell order and a buy order, it offsets.
22 And the balance, they would just pass it to banks, other firms, or Manila Exchange." *Exh. S-35a, p.*
23 *42*. Other than that, Cho did not know "what's going on over there." *Exh. S-35a, pp. 43, 80-81*.

24 Q. Did you ever feel any obligation to find out what was happening to customer orders
25 that were being sent to Eastern Vanguard Forex Limited?

26 A. Maybe, but not really.

Q. And you never felt any need to find out so that you could tell clients or account
holders of trading accounts?

1 A. Could you repeat that again, please.

2 Q. Did you ever feel that you had any need to find out how orders were executed so you
could explain that to clients or account holders of trading accounts?

3 A. Probably so. That's why I had a discussion with Mr. Tam.

4 Q. And his explanation satisfied you?

5 A. Maybe not 100 percent, but yes, it did.

6 *Exh. S-35a, pp. 43-44.* When asked whether any information was provided during training as
7 to how EVFL executes orders received from FISC, Cho said: "Not specifically." *Exh. S-35a, p. 87.*
8 Simmons was not sure what happened to a customer order relayed from FISC to Macau because no
9 one ever explained it to him. *Exh. S-36a, pp. 47-48.* Nor was he sure whether an order was executed
10 in Macau or San Francisco. *Exh. S-36a, p. 58.* However, he nonetheless told investor Al Davis that
11 orders from FISC were placed on the "Chicago exchange." *H.T., pp. 116, 418.* FISC trader Dan
12 Hoesch did not know exactly how EVFL executed orders from FISC, but believed that his orders
13 were being executed with banks. *H.T., pp. 2476-77.* Investors Willis Scott, Melba Davis, Ruth
14 Shumway, Michael Noriega and Joseph Saxon testified they was not provided any information
15 about order execution by EVFL. *H.T., pp. 248-50, 979-80, 1082-83, 1223, 1340-41.* Trader Bill
16 Nagorny also testified that his investor father was not provided with this information. *H.T., p. 488-*
17 *89.*

18 Percy Lung Siu Hung ("Percy Lung" or "Lung"), chief dealer at the EVFL Macau office
19 since it opened in 1994, testified he was "responsible for the order execution." *Exh. S-82, pp. 29, 37,*
20 *38.* He admitted that *every* order received is sent outside EVFL, *Exh. S-82, p. 51,* and that most
21 accountholder orders from FISC were "placed" with only one firm, Golden Profit Development
22 Limited in Macau. *Exh. S-82, pp. 21, 40-41.* Lung also admitted he never did a dealing transaction
23 for EVFL with a bank, *Exh. S-82, p. 43,* and that in fact "we can't place an order with any Hong
24 Kong Bank here because there is an Ordinance here in Hong Kong restricting us from doing this."
Exh. S-82, p. 22. Trading account investors had no due diligence burden of investigation to ask for
this information. *See Trimble, 152 Ariz. at 553, 733 P.2d at 1136.*

25 **e. Misleading Omission of Interest Charge and Interest Risk Information**

26 The Division alleged that the primary Respondents specifically failed to disclose the terms

1 under which interest was charged or paid on overnight positions, or the risk of loss to a customer
2 account due to adverse interest or "premium" charges resulting from maintaining an overnight
3 position. EVFL accounts with an overnight buy position in Deutsche marks, Swiss francs and
4 Japanese yen or an overnight sell position in Pound sterling would be charged interest each calendar
5 day on a fixed percentage basis. *Exhs. S-35a, pp. 82-83, 85; S-36a, pp. 53-54, 97-99.* Accounts with
6 an overnight sell position in the first three currencies would earn daily interest at a lesser rate. *Exhs.*
7 *S-35a, p. 86; S-36a, pp. 55, 97-99.* "The way it works," said Cho, "is trading days are from Monday
8 to Friday. Monday, Tuesday, Thursday, Friday they're charged one day, but on Wednesday, it's
9 charged three days." The three-day charge on Wednesday covers the weekends. *Exh. S-35a, p. 86.*
10 Cho admitted an investor will always pay a higher rate of interest than could be received. *Exh. S-*
11 *35a, p. 86.* Simmons did not know the basis for setting the percentage or why more interest was
12 charged than paid. *Exh. S-36a, pp. 54, 55.* Both Cho and Simmons admitted that neither FISC
13 brochure, *Exhs. S-44 or S-47*, nor the EVLF Customer Agreement, *Exh. S-43*, explained under what
14 circumstances interest would be charged or paid. *Exhs. S-35a, pp. 84-85; S-36a, p. 65.* Simmons
15 admitted these brochures did not disclose the effect of interest on accounts maintaining overnight
16 positions. *Exh. S-36a, p. 65.* Simmons also admitted that a four-page letter he provided to
17 prospective clients failed to make such disclosure. *Exh. S-36a, p. 65.*

18 Cho admitted that an overnight position could remain open indefinitely, for weeks or even
19 months. *Exh. S-35a, pp. 81-82.*

20 Q. Is it fair to say then that when an open position is carried for a period of time such as
21 several weeks and interest is being paid by the account holder that that, those payments can
add up to a substantial amount of the account equity?

22 A. Probably so. You don't realize it, but after a while, when you calculate it, then you
see it.

23 *Exh. S-35a, p. 87.* Percy Lung, chief dealer at the EVFL office in Macau, also testified that
24 an overnight position can remain open for months -- "As long as you have a sufficient margin." *Exh.*
25 *S-82, pp. 41-42.* Cho was not sure whether any trader ever explained the FISC account statement to
26 a prospective investor. *Exh. S-35a, p. 77.*

1 Investors Willis Scott, Al Davis, Melba Davis, Ruth Shumway, Michael Noriega and Joseph
2 Saxon testified that nobody disclosed to them before they opened their accounts about the terms for
3 EVFL charging or paying interest, nor the risk of loss to their investments from interest charges.
4 *H.T.*, pp. 250-51, 419, 980, 1083, 1223-24, 1341. Trader Bill Nagorny also testified that his investor
5 father was not provided with this information. *H.T.*, p. 489, 491. Simmons admitted to Alan Davis
6 after his account was closed that while Davis received \$450.80 in interest, he paid over \$2,040.49 in
7 interest. *Exh. S-62*, pp. 24. Trading account investors had no due diligence burden of investigation to
8 ask for this information. *See Trimble*, 152 Ariz. at 553, 733 P.2d at 1136.

9 **f. Misleading Omission of Information About Use of Investor Funds**

10 Our court of appeals has found a misleading omission of material fact in the failure of a
11 commodity investment contract issuer to disclose the storage location for investor gold and silver.
12 *Goodrich*, 151 Ariz. at 126-127, 726 P.2d at 223-224. The Division alleged in this matter that the
13 primary Respondents specifically failed to disclose the location and use of investor funds after
14 deposit with FISC and EVFL and while such funds were credited to investor accounts. Neither the
15 FISC brochures admitted as Exhs. S-44 and S-47 nor the EVFL Customer Agreement admitted as
16 Exh. S-43 provide such disclosure. Simmons did not know what happened to investor deposit
17 checks after FISC sent them to Tokyo in San Francisco. *Exh. S-36a*, pp. 100-101. FISC trader Dan
18 Hoesch knew that investor funds were deposited in a Citibank account in San Francisco, but thought
19 each investor was provided a separate account there. *H.T.*, pp. 2478-79. Cho said he told a
20 prospective investor that "once they give us the money, that it will be deposited in the Eastern
21 Vanguard's account at Citibank in San Francisco."

22 Q. And did you ever discuss what would happen to those funds after they were
deposited there.

23 A. I *might* have.

24 Q. What is your knowledge of what happens to those funds after they are deposited in
the bank account?

25 A. I never saw the bank account, so I do not know for sure, but from my understanding
from Mr. Tam, it either stays there or it is sent to Macao, depending on the account situation,
if there is more margin needed in Macao.

26 Q. And is that what you would have told a client if the client asked you what happened

after the money is deposited?

A. That's the way I would have answered, correct. *Usually clients didn't ask me that question.* Usually the traders would ask me that question.

Exh. S-35a, p. 89. (Italics added.) Cho should not have withheld this information unless an investor specifically requested it. Trading account investors had no due diligence burden of investigation to ask for this information. *See Trimble*, 152 Ariz. at 553, 733 P.2d at 1136. Respondents were under an affirmative duty not to mislead investors. *Id.* Cho and the other primary Respondents were under a duty to initiate disclosure of such information.

Investors Willis Scott, Al Davis, Melba Davis, Ruth Shumway, Michael Noriega and Joseph Saxon testified that before they opened their accounts nobody disclosed to them the location and use of their funds by EVFL after they invested. *H.T., pp. 251, 419, 980, 1083, 1224, 1341-42.* Trader Bill Nagorny also testified that his investor father was not provided with this information. *H.T., p. 492.*

Investors' funds were in fact deposited into EVFL's Citibank account no. 600948608 in San Francisco. *Exhs. S-37a, p. 73-44; S-183; S-184.* No information was provided in this matter about the handling of investor funds in the Citibank account between the 1996 opening of FISC and June 13, 1997. Between the later date and November 5, 1997, all wire transfers from this account went to EVFL's Marine Midland Bank account no. 07465-9 in New York City which "receives funds from companies throughout the world who have their accounts serviced by EVFL. EVFL primarily used this account to receive and/or pay funds related to trading gains and/or losses at the companies it services and to pay other business related expenses. Once investors' funds are deposited into this account, it becomes impossible to trace the funds." *Exh. S-183; S-184.* No information has been provided in this matter about the handling of investor funds in the Citibank account after November 5th.

g. Misleading Omission of Information About Investor Risk of Loss From Noncompliance Policy

The Division alleged that the primary Respondents specifically failed to disclose EVFL and FISC policy that their offer or sale of Forex trading accounts were not subject to state or federal

1 securities law, and the attendant risks to investors of non-compliance with the investor protection
2 provisions of those laws. Neither the FISC brochures admitted as Exhs. S-44 and S-47 nor the EVFL
3 Customer Agreement admitted as Exh. S-43¹⁶ provided such disclosure. As early as July-August of
4 1996, trainee Aaron Lawson pressed Dionisio for an explanation why traders should not be
5 registered in order to solicit investor funds. *H.T.*, pp. 1767-1772. Lawson was told someone was in
6 contact with the Commission about it, *H.T.*, p. 1771, and later that the Commission decided to take
7 no action "and we were free to solicit." *H.T.*, pp. 1772, 1797. About "a week or two later," Dionisio
8 showed him a no-action letter *from* the Division on Commission letterhead. *H.T.*, p. 1772-74.

9 Q. (BY MR. KNOPS) After you read the document what was your reaction to it.

10 A. It didn't satisfy me.

11 Q. Do you remember anything about the contents of the letter?

12 A. No. It was legalese but I do remember that to me all it said is that you're not going to
13 pursue the matter at this time but you reserve the right to, or the Corporate Commission
14 reserves the right to come in at any moment.

15 Q. Did you indicate to Mr. Dionisio that you were still not satisfied?

16 A. Yes I did.

17 Q. What was the outcome then of your uneasiness?

18 A. I left the firm.

19 *H.T.*, p. 1778. The only Division letter sent in response to a no-action request from FISC or
20 EVFL was dated October 17, 1997, over a year later. *H.T.*, p. 1500. The Division denied the request.
21 No one ever discussed with Lawson whether FISC needed to be licensed. *H.T.*, p. 1787. During this
22 same July-September period, FISC trainee Charles Stember told Dionisio and Tam that FISC traders
23 had to be licensed to solicit investors. *H.T.*, pp. 1728-35. Tam disagreed with Stember and argued
24 with him. *H.T.*, p. 1734. Stember even brought in a lawyer to talk with Tam. *H.T.*, pp. 1733-35.

25 FISC and EVFL did send to the Division a no-action letter request from their counsel dated
26 August 23, 1996, asserting that "the sale of contracts for foreign currency" did not involve securities

24 ¹⁶ When asked if he thought he "would have to be a lawyer to under stand" some of the provisions in the
25 EVFL Customer's Agreement, Cho answered: "I think so. When I first saw this agreement at Tokyo, I mean, it
26 wasn't easy, but I just assumed that -- I just assumed that everything is all proper information. Something that when
you open a currency investment that similar language everywhere you go." *H.T.*, pp. 2889-90. When asked why he
assumed such, Cho responded: "I don't know. It's not -- I just trusted the company people that I was working with."
H.T., p. 2890. Investor Al Davis said about the same thing. *H.T.*, pp. 130-01.

1 within the jurisdiction of the SAA. *Exh. S-61*. This request was couched in language intimating that
2 "FISC's Proposed Business" had not yet begun in Arizona, failing to disclose that FISC was already
3 engaged in the offer and sale of EVFL trading accounts. *Exh. S-61, pp. 2-3*. In fact this request was
4 made while FISC was in the middle of its telemarketing sales campaign. *H.T., pp. 1725, 1743*. The
5 solicitation and recruiting of investors by these Respondents did not abate while their request was
6 pending or even after it was denied. Moreover, the request was never disclosed to investors while it
7 was pending or after its denial. Tam assured Cho that there was "no problem" regarding the "state of
8 Arizona no-action letter." *H.T., p. 3030*. Cho in turn assured FISC *trainees* "that there is no direct
9 regulation" and that they needed no license to trade currency. *Exh. S-35a, pp. 89-90*. FISC trader
10 Dan Hoesch did not even discuss the issue of registration with his two clients, investors Schnad and
11 Barry. *H.T., pp. 2503, 2514*. When asked if he ever explained the risks of non-regulation to either
12 traders or prospective clients, Cho said: "No, I did not go into detail like that." *Exh. S-35a, p. 90*.

13 Q. Did you warn them, for example, that if Eastern Vanguard Forex Limited were to go
14 out of business the next day, that there's no guarantee that their funds would be returned to
15 them?

16 A. Probably so. I asked them, *people would ask questions*, "Is there insurance." I said
17 there is no insurance. And I did tell people *if they asked specific questions*, I would tell them
18 yes, if they want to take off with the money, they can take off any time, but I would also say
19 they probably would not. They've been doing business for a long time, and they will not take
20 off with the clients' money.

21 *Exh. S-35a, pp. 90-91*. (Italics added). Trading account investors had no due diligence
22 burden of investigation to ask such questions. *Trimble*, 152 Ariz. at 553, 733 P.2d at 1136.
23 Respondents were under an affirmative duty not to mislead investors. *Id.*

24 Simmons echoed Cho on regulatory disclosure:

25 Q. After an account holder deposits a sum for the purpose of opening a trading account,
26 is there any insurance or other protection available for that account holder in the event that
the Tokyo office closes down or the Macao office closes down or even the FISC office here
in Phoenix closes down?

A. Not that I'm aware of.

Q. Are you aware of any kind of registration or licensing by FISC for purposes of
making these trading accounts available to the public?

A. Making them public?

Q. Licensing or registration with any state or federal regulatory body?

A. Not that I'm aware of.

1 Q. Have you ever been asked by a prospective client or an account holder as to whether
FISC is licensed, or Eastern Vanguard?

2 A. Yes.

3 Q. And what has been your response?

4 A. No.

5 Q. And do they ask you why not?

6 A. Actually, one did ask me why not, and I didn't have an answer.

7 Q. Have you ever asked Mr. Tam or anybody else why FISC is not licensed?

8 A. No. I was told we didn't need one, and that was good enough for me.

9 Q. *Do you ever volunteer the information to a prospective client that there is no
licensing or registration at all of these accounts?*

10 A. *No, I wouldn't say I volunteer, but I don't hide it either.*

11 Q. *Well, do you give them any kind of risk disclosure to the effect that these are not
licensed or registered with any state or federal authority as investment vehicles?*

12 A. No.

13 Q. *Do you give them any kind of risk disclosure that the money they're placing on
deposit is not protected by any kind of regulatory insurance that's required for investors
putting money on deposit?*

14 A. No.

15 Q. Do you know anything about the financial condition of Eastern Vanguard?

16 A. No, I don't.

17 *Exh. S-36a. p. 101-103. (Italics added.)* Trading account investors had no due diligence
burden of investigation to ask for this information. *See Trimble*, 152 Ariz. at 553, 733 P.2d at 1136.

18 Investors Al Davis, Melba Davis, Ruth Shumway, Michael Noriega and Joseph Saxon
testified that the FISC-EVFL policy regarding state and federal regulation was not disclosed to
them, nor the risks of their non-compliance with regulatory protections for investors. *H.T.*, pp. 419,
980-81, 1083-85, 1224-25, 1342-43. Investor Willis Scott was told they were not subject to
regulation, but not about the attendant risks. *H.T.*, pp. 252-53. Trader Bill Nagorny testified that his
investor father was not provided with this information. *H.T.*, p. 492-95. Investor Al Davis did not
even read the EVFL Customer's Agreement before signing it because he assumed it conformed to
regulatory requirements:

21 Q. (BY MR. KNOPS) Aren't you concerned when you go to a mortgage broker or a
car loan financing agent or a brokerage house, that someone is going to bury something in
the text there that's going to come back and bite you?

22 A. No, because usually there's protections in the law that -- that -- that shelter the
consumer from that. We're usually a consumer-friendly nation, as far as the laws go, and I
figured if there was anything legal or illegal, that it probably would have been taken care of.

23 ...
24 Q. (BY MR. KNOPS) So is it fair to say that in these other contexts, you're
assuming that those documents you signed are subject to regulation.

25 A. Yes.

1 THE WITNESS: In my past practice, when I've signed car loans and mortgage
2 papers and went into mutual funds and things, I have never encountered anything illegal.

3 And so that was how I was looking at this agreement, the same way, that it was an
4 agreement that was going to protect me so ...

5 *H.T., pp. 130-01.*

6 2. Fraudulent Transactions, Practices or Courses of Business

7 The Division alleged that in connection with their offers or sales of securities through FISC,
8 the primary Respondents directly or indirectly engaged in transactions, practices or courses of
9 business which operated or would operate as a fraud or deceit upon offerees and investors within the
10 meaning of A.R.S. A.R.S. § 1991, including but not limited to presenting EVFL and FISC salesmen
11 as professional currency traders able to make sound investment decisions on behalf of investors,
12 while such salesmen had insufficient training and experience in Forex-related trading and made
13 unsound investment decisions that caused substantial losses by investors. Simmons has not
14 contested this allegation.

15 The elements of securities fraud under A.R.S. § 1991(3) are as follows:

- 16 1. in connection with a transaction or transactions
- 17 2. within or from Arizona
- 18 3. involving an offer to sell or buy securities, or their sale or purchase
- 19 4. to directly or *indirectly*
- 20 6. engage in
- 21 7. any transaction, practice or course of business
- 22 8. which operates or *would operate* as a fraud or deceit.

23 This subsection is similar to that found at § 17(a)(3) the federal Securities Act of 1933
24 ("1933 Act"). *See State v. Superior Court*, 123 Ariz. 324, 331, 599 P.2d 777, 784 (1979)¹⁷,
25 *overruled in part on other grounds, Gunnison, id.*, 127 Ariz. at 113, 618 P.2d at 607; *State v.*

26 ¹⁷ The Arizona Supreme Court opined: "The provisions of A.R.S. s 44-1991 are almost identical to the
antifraud provisions of the 1933 Securities Act, 15 U.S.C. s 77q (1970)." *Superior Court*, 123 Ariz. at 331, 599 P.2d
at 784.

1 *Barber*, 133 Ariz. 572, 575 n. 1, 653 P.2d 29, 32 n. 1 (Ct. App. 1982), *aff'd*, 133 Ariz. 549, 653 P.2d
2 6 (1982); *Greenfield v. Cheek*, 122 Ariz. 70, 73, 593 P.2d 293, 296 (Ct. App. 1978), *aff'd*, 122 Ariz.
3 87, 593 P.2d 280 (1979), *overruled in part on other grounds*, *Gunnison, id.*, 127 Ariz. at 113, 618
4 P.2d at 607; *Baker v. Walston & Company*, 7 Ariz. App. 590, 593, 442 P.2d 148, 151 (Ct. App.
5 1968). Under our supreme court mandate in *Gunnison, id.*, 127 Ariz. at 112-113, 618 P.2d at 606-
6 607, to follow the United States Supreme Court in interpreting this federal counterpart, *scienter* is
7 not an element of this SAA subsection.¹⁸ See *Aaron v. Securities and Exchange Commission*, 446
8 U.S. 680, 696, 100 S.Ct. 1945, 1956, 64 L.Ed.2d 611 (1980).

9 The primary Respondents operated a machine of deception through FISC whose only
10 purpose was to raise investor funds for high-risk trading through EVFL. The machine was fueled by
11 short-lived trainee traders who were pushed to raise trading funds from friends and family, then
12 discarded when these funds had been lost. The recruiting of investors required the constant
13 recruiting of trader trainees. When the machine stumbled its first year after opening, Cho was
14 brought in from San Francisco to place it back on track. Cho described his discussion about the lack
15 of FISC investors with Tam when he was invited to be its marketing manager. *Exh. S-35a, pp. 67-*
16 *68.*

17 Q. And did you have anything particular in mind as to how you could solve the problem
18 there?

18 A. Can you repeat the question again, please.

19 Q. Did you have any ideas as to how you could get clients for FISC when you made the
20 decision to accept the job?

20 A. Yes, I did.

21 Q. And what were those ideas.

21 A. Same thing what we were doing at Tokyo International Investment.

22 Q. Which would include running ads and inviting applicants to undergo training to
23 become traders?

24 ¹⁸ The Idaho Securities Act antifraud provision at I.C. § 30-1403 (1967) provides in relevant part: "It is
25 unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly ... (3) to
26 engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any
person." Noting that § 17(a)(3) the federal 1933 Act is "virtually identical" to this provision, the Idaho Supreme
Court held that *scienter* is not an element of securities fraud under this state act subsection, citing *Aaron v. Securities
and Exchange Commission*, 446 U.S. 680 (1980) for authority. See *State v. Shama Resources Limited Partnership*,
127 Idaho 267, 272, 899 P.2d 977, 982 (1995).

1 A. Correct.

2 Q. Were you aware whether that activity had already been going on at FISC?

3 A. Yes.

4 Q. And why did you think you could do it better than what had already been done and failed?

5 A. Because I've done it in San Francisco and in Los Angeles.

6 *Exh. S-35a, p. 68.* Cho admitted that the whole purpose of the training program was to develop traders who would bring in new accounts. *H.T., p. 2838.* Even during in the first two weeks of classroom training marketing was talked about "in terms of everybody knew that we had to get clients to make money. When I say "we" I'm talking about the traders, the trainees. That was the goal." *H.T., p. 2972.* They talked about marketing in terms of "how is your client search coming along, do you have any names of clients and that sort." *H.T., pp. 2972-73.*

7 Traders were recruited by FISC placing newspaper ads.¹⁹ *Exh. S-35a, p. 17.* People responding to the ads would be interviewed by the marketing manager and his assistants, and candidates chosen and invited to undergo training. *Exh. S-35a, p. 17.* Cho testified that he "was looking for people who had ambition, who wanted to make money, hard working. That's about it."

8 Q. Did you have a requirement that the applicant have a background in currency trading?

9 A. I did not.

10 Q. Was that a desirable feature?

11 A. Not necessarily.

12 Q. Why not?

13 A. Why not that it was not desirable?

14 Q. Right.

15 A. Well, first of all, currency trading is not something that everyone does. There's not that many people who have currency background, and currency trading at FISC is something that, something that we felt that we can train even with someone who did not have any experience or background.

16 *Exh. S-35a, p. 18.* FISC trader Dan Hoesch did not meet a single trainee with any background in foreign currency trading in the three classes he helped teach after Cho took over.

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24 ¹⁹ A classified ad FISC placed in May 1996 under "Sales & Marketing" in Phoenix newspapers was titled "ASSOCIATE" "Investment Management," and announced: "Expanding int'l firm offers challenging opportunity in foreign exchange." *H.T., 1496-98; Exh. S-38.* The "Expanding int'l firm" was obviously EVFL, not FISC with its one office in Phoenix. A later ad published in February 1997 after Cho arrived was titled "Foreign Currency Trader" and stated: "Expanding international firm seeks motivated, ambitious and hard working person. No experience necessary. High income potential. Paid training." *H.T., pp. 1498-99; Exh. S-39.*

1 *H.T.*, pp. 2487-88. Hoesch himself solicited "close to 100 people" to invest, *H.T.*, p. 2475, and
2 provided FISC literature to about one-third of these offerees. *H.T.*, pp. 2475-76.

3 Trainees were paid \$500 monthly for two months. *Exh. S-35a*, p. 21. A trainee qualified to
4 trade at FISC by completing the training program. *H.T.*, p. 2784; *Exh. S-35a*, p. 79. Trading could
5 begin when an account was opened to trade from. *Exh. S-35a*, p. 80. Cho never refused a check
6 presented to open a trading account. *H.T.*, p. 2787. Cho handled sessions on marketing for the
7 trainees. *H.T.*, p. 2778. The printed materials provided to trainees included an item stating in part:

8 The odds of making money from Forex Trading are inconsistent. A fairly high
9 proportion stop trading within 6 months because of excessive losses. Some traders are
10 fortunate to do well at the beginning. Invariably, they become over confident and lose all
their early profits. Because they have tasted limited success, they are likely to keep trading
longer and lose more than somebody who has lost consistently from the beginning.

11 Other than gambling, there is probably no human endeavor with such a low success
rate that continue to attract such a large number of participants.

12 *H.T.*, pp. 2780-81; *Exh. R-13*. Cho admitted there was a high risk of traders losing money on
13 their first accounts. *H.T.*, p. 2823. He testified that he agreed with the above extract, *H.T.*, p. 2781,
14 and conceded that it focused on the likelihood of losses. *H.T.*, p. 2783.

15 Q. Did you recommend to the traders that they provide that sheet to prospective clients -

16 A. No.

17 Q. -- as part of the risk disclosure?

18 A. No, I did not.

19 Q. Why not?

20 A. This was part of our training material, not marketing material or part of a customer
agreement. I was not instructed by the company, either at FISC or at Tokyo International, to
provide this document.²⁰

21 *H.T.*, p. 2783. Nor did Cho advise his trainees to orally disclose to prospective clients the
likelihood a new trader would lose investor money for the first accounts traded:

22 Q. Did you recommend to the trainees that they tell their clients that the chances of
losing on the first accounts are very high?

23 A. Did I encourage them to tell their clients?

24 Q. Yeah, disclose that to their clients.

25 A. No, I did not.

26 ²⁰ FISC trader Dan Hoesch testified that he never provided this sheet to anyone he solicited. *H.T.*, pp. 2491-
92. When asked why he didn't, he responded: "I don't know." *H.T.*, p. 2492. He gave the same answer when asked
why he never included the information from that sheet in a client solicitation letter. *H.T.*, p. 2493.

1 *H.T.*, p. 2780. In view of his admission that new traders run a high risk of losing money on
2 their first accounts, *H.T.*, p. 2823, Cho was asked why he allowed them to provide prospective
3 investors with Exh. S-44, the FISC "Foreign Exchange Services" brochure," which states that traders
4 have the discipline and ability to make sound investment decisions:

5 A. Well, first of all, I was not aware that was there, number one, and even if it was
6 there, that's -- I was told to do it that way. It was there. It was provided to me to give to
traders by the company.

7 Q. Did Tokyo International have a brochure substantially the same as S-44 during the
entire period of time that you were there at Tokyo?

8 A. It was very similar, yes.

9 Q. So from April or May of '95 all the way to the end of '97?

10 A. Yes.

11 Q. And did you give them out yourself to prospective clients?

12 A. I probably did.

13 Q. And when you came over to the office at FISC in January of '97, did you look at the
materials that were used in the office there for the traders?

14 A. Yes, I did.

15 Q. And at no time were you aware of this sentence on this sheet of S-44?

16 A. I didn't really pay attention because Mr. Tam told me it was basically the same thing
as San Francisco's brochures.

17 *H.T.*, pp. 2823-24.

18 Cho admitted that when Alan and Debbie David opened their account at the FISC office, he
19 congratulated them and chatted with them, but failed to tell them that it was Simmons' first account
20 and there was a high risk he would lose money in trading it. *H.T.*, pp. 2826-27. Nor did Cho query
21 Simmons whether he disclosed to the Davises that it was his first account. *H.T.*, p. 2827.

22 Cho also admitted that when F. Dean and Melba Davis opened their account at the FISC
23 office, he talked with them, noticed that they were elderly, but failed to ask them if they could afford
24 to lose the \$50,000 they invested. *H.T.*, pp. 2833-34. "Maybe looking back I should have done a
25 personal inquiry, but I did not really go into that," Cho conceded. *H.T.*, p. 2837. Nor did he advise
26 them that since they were only Simmons' second account, there was a high risk he would lose
money in trading it. *H.T.*, p. 2835. In fact, he admitted he knew when Dean and Melba invested that
Simmons had already lost money in their son's account opened previously. *H.T.*, p. 2840. When
asked if Simmons' losses in trading Alan and Debbie Davis' account aroused his concern about new

1 traders losing money, Cho admitted that he "did not think about that at the time." *H.T.*, p. 2840.

2 Q. Is it fair to say that you didn't consider it important to warn Dean and Melba Davis
3 that Mr. Simmons was losing money on Alan Davis' account, and theirs was only the second
4 account to be opened by him?

5 A. Yeah. It's fair to say that.

6 *H.T.*, p. 2841.

7 Cho admitted that while discussing marketing with trainees, he told them they could tell
8 prospective investors that "we would try to make 3 to 5 or 4 to 5 percent a month." *H.T.*, pp. 2849-
9 50. "When I mentioned those numbers," Cho explained, "it was -- I was talking about on the
10 average and to tell that on the average. Sure, 4 to 5 percent is not a big deal in the currency market."
11 *H.T.*, pp. 2851-52. Cho and Tam told trainees not to discuss with each other the results of their
12 trading or their client solicitation. *H.T.*, p. 2474.

13 Cho testified that in the evening of December 2, 1997, he personally recounted to Tam what
14 he was told that same day by Al Davis about Simmons' untrue representations. *H.T.*, pp. 2932-33,
15 3028, 3029. He further testified that Tam "expressed his disapproval with the things that apparently
16 James had said." *H.T.*, p. 2934. Nevertheless, Simmons remained as FISC marketing manager until
17 the office was closed on December 18, 1997. *H.T.*, pp. 560, 562, 2936.

18 The overall deception operated by the primary Respondents was that the trading of foreign
19 currencies through EVFL and FISC was an *investment*, while they concealed that investor funds did
20 little more than "play the market" as Cho cynically reiterated in his testimony. *H.T.*, pp. 2227, 2228,
21 2229, 2233, 2235, 2907, 2908.

22 **B. Secondary or Vicarious Liability Under A.R.S. § 44-1999**

23 In connection with the A.R.S. § 44-1991 violations alleged against FISC and EVFL, the
24 Division also alleged that certain Respondents directly or indirectly controlled these persons within
25 the meaning of A.R.S. § 44-1999, thereby making the controlling Respondents jointly and severally
26 liable to the same extent as the controlled persons for such violations. Simmons has not contested

1 this allegation. This secondary or vicarious liability is imposed on a "Controlling person" by A.R.S.
2 § 44-1999 because another "controlled person" has violated the SAA.

3 The relevant²¹ portion of this statute states: "Every person who, directly or *indirectly*,
4 controls any person liable for a *violation* of §§ 44-1991 or 44-1992 shall be liable jointly and
5 severally with and to the same extent as the controlled person to any person to whom the controlled
6 person is liable unless the controlling person acted in good faith and did not directly or *indirectly*
7 induce the act underlying the action." (Italics added.) Each specific violation of A.R.S. § 44-1991
8 alleged against all primary Respondents in this matter is an "act" for the purpose of imposing
9 statutory vicarious liability under A.R.S. § 44-1999. Some of these primary Respondents are
10 *alternatively* alleged to be subject to vicarious liability as control persons under A.R.S. § 44-1999.

11 The words "controlling person" and "controls" are neither defined in the statute nor
12 elsewhere in the SAA for purposes of this statute. However, the 1996 enactment that added this
13 statute specified a permissive intent that in construing SAA provisions "the courts *may* use as a
14 guide the interpretations given by the securities and exchange commission and the federal or other
15 courts in construing substantially similar provisions in the federal securities laws of the United
16 States." *Laws 1996*, Ch. 197, § 11(C). (Italics added.) Since the relevant part of this statute has
17 language "substantially similar" to the Section 20(a) "control person" provision in the federal
18 Securities Exchange Act of 1934 ("1934 Act"),²² the Commission in its adjudicative capacity may
19

20 ²¹ This relevant portion is the second of two sentences comprising A.R.S. § 44-1999. The first sentence does
21 not apply to control liability predicated on the violation of A.R.S. § 44-1991 and therefore is inapplicable to this
22 matter.

22 ²²Sec. 20(a) states: "Every person who, directly or indirectly, controls any person liable under any provision
23 of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same
24 extent as such controlled person to whom such controlled person is liable, unless the controlling person acted in
25 good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15
26 U.S.C. § 78t(a). The federal 1933 Act also has its own "control person" provision at Section 15 with different
language similar to the first sentence in A.R.S. § 44-1999. Although the affirmative defense clauses differ in the two
federal statutes, the threshold issue of control under both statutes is determined by the same decisional law standard.
See, e.g., Abbott v. Equity Group, Inc., 2 F.3d 613, 619 n. 15 (5th Cir. 1993), *cert. denied* 510 U.S. 1177 (1994) (both
statutes interpreted with same controlling person definition); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1578
(9th Cir. 1990), *cert. denied* 499 U.S. 976 (1991) (same controlling person analysis under both statutes); 3 A.
Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud* § 8.5 (810) (2d ed. 1996) (hereinafter

1 look to the interpretations given to that federal provision. In visiting such interpretations, however,
2 the Commission *must* follow the legislative "Intent and Construction" mandated for the SAA by
3 *Laws 1951*, Ch. 18, § 20:²³

4 The intent and purpose of this Act is for the protection of the public, the preservation
5 of fair and equitable business practices, the suppression of fraudulent or deceptive practices
6 in the sale or purchase of securities, and the prosecution of persons engaged in fraudulent or
7 deceptive practices in the sale or purchase of securities. This Act shall not be given a narrow
8 or restricted interpretation or construction, but shall be liberally construed as a remedial
9 measure in order not to defeat the purpose thereof.²⁴

10 While the legislative purpose for the SAA is clearly investor protection,²⁵ the federal
11 securities laws instead serve multiple purposes. *See, e.g., United States v. Naftalin*, 441 U.S. 768,
12 775-76, 99 S.Ct. 2077, 2082-83, 60 L.Ed.2d 624 (1979) (investor protection not sole purpose of
13 federal 1933 Act). Therefore, the Commission may only look to interpretations of federal law that
14 comport with the protective purpose of the SAA.²⁶ Indeed, Arizona courts have consistently
15 construed the SAA in an expansive fashion resulting in greater liability than exists under federal
16 securities law. *Grubaugh v. DeCosta*, 1 CA-CV 97-0477/ 1 CA-CV 98-0060 (Consolidated), slip.

17 "Bromberg & Lowenfels").

18 ²³ "When the text of a statute is capable of more than construction or result, legislative intent on the *specific*
19 *issue* is unascertainable, and *more than one interpretation is plausible*, we ordinarily interpret the statute in such a
20 way as to achieve the general legislative *goals* that can be adduced from the body of legislation in question."
21 *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 42-43, 945 P.2d 317, 353-54 (Ct. App. 1997). (Italics
22 added.)

23 ²⁴ Division One of our Court of Appeals recited this legislative statement in *Grubaugh v. DeCosta*, 1 CA-
24 CV 97-0477/ 1 CA-CV 98-0060 (Consolidated), slip. op. at 12 (Ct. App. March 16, 1999), in support of a "broader
25 interpretation of liability" under the SAA than under federal securities law.

26 ²⁵ The "basic purpose" of the SAA is "the prevention of fraud upon the consumers of securities." *People ex*
27 *rel. Babbitt v. Green Acres Trust*, 127 Ariz. 160, 166, 618 P.2d 1086, 1092 (Ct. App. 1980). "The securities laws are
28 designed to protect less-than-prudent investors from giving their money to irresponsible or unscrupulous
29 businessmen." *Nutek Information Systems v. Arizona Corp. Com'n*, 1998 WL 767176 at 5 (Ariz. Ct. App. 1998). The
30 Arizona Supreme Court has declared that regulation of securities is "designed to protect the public from fraud and
31 deceit arising in those transactions. Since much of the public lacks the knowledge and sophistication of those who
32 trade regularly in the securities marketplace, blue sky laws act as a buffer between purveyors of worthless securities
33 and that segment of the public which can ill afford to fall victim to fraudulent investment schemes." *State v.*
34 *Baumann*, 125 Ariz. 404, 411, 610 P.2d 38, 45 (1980) (In Banc).

35 ²⁶ "Because state securities laws should be more broadly construed than federal securities laws, and *because*
36 *of our legislative mandate*, this Commission *must* broadly interpret the Act as a remedial measure to ensure *the*
37 *protection of Arizona investors*." *In the Matter of the Offering of Securities By: The Woodington Group, Inc. et al.*,
38 Arizona Corporation Commission Decision No. 58113 (December 10, 1992), p. 11. (Italics added.)

op. at 11 (Ct. App. March 16, 1999).

1. The Test for Control

The threshold issue is whether a person controlled a primary violator.²⁷ See *Kersh v. General Council of Assemblies of God*, 804 F.2d 546, 548 (9th Cir. 1986). The person alleging control bears the burden of proving it. E.g., *G. A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 958 (5th Cir. 1981). Since Section 20(a) of the federal 1934 Act also does not define control,²⁸ *Harriman v. E. I. Dupont De Nemours & Co.*, 372 F. Supp. 101, 104 (D.Del. 1974), and the U. S. Supreme Court has not addressed this issue, lower federal courts have developed different tests for control.²⁹ One leading authority identifies five different tests used by federal courts. See 3 A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud* § 8.5 (832) (2d ed. 1996) (hereinafter "Bromberg & Lowenfels").

Of these tests, two appear to most closely match the investor protection purpose of the

²⁷ This determination is analogous to whether a person is a principal subject to vicarious liability for the acts of an agent. However, the legislative history of Sec. 20(a) appears to support a congressional intent to extend liability beyond normal common law concepts of a principal's responsibility for the actions of an agent. Bromberg & Lowenfels, *supra* § 8.5 (821); see *Harriman v. E.I. DuPont De Nemours and Company*, 372 F.Supp. 101, 104 (D.Del. 1974). "Sec 20(a) ... was intended 'to prevent evasion' of the law 'by organizing dummies who will undertake the actual things forbidden,'" *Hollinger*, 914 F.2d at 1577, and to impose liability on "the [person] who stands behind the scenes and controls the [securities violator] who is in a nominal position of authority." *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1441 (9th Cir. 1987) (quoting 1934 legislative history).

²⁸ For purposes of registration and reporting under the 1934 Act, Rule 12b-2 under that Act defines "Control" as follows: "The term 'control' (including the terms 'controlling,' 'controlled by' and 'under common control with') means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 CFR § 240.12b-2. (Italics added.) Rule 405 of Regulation C under the 1933 Act has an identical definition of control. See 17 CFR § 230.405. Federal and state courts have relied upon this definition to help define "control person." 12A J. Long, *Blue Sky Law* § 7.08(3) (1984 rev. ed., 11/98 supp.); see, e.g., *G. A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 957-958 (5th Cir. 1981) (Rule 405 provides standard for Sec. 20[a] liability); *Abbott*, 2 F.3d at 619 n. 15.

²⁹ "Congress deliberately did not define 'control,' thus indicating its desire to have the courts construe the applicable provisions of the statute along with the evidence adduced at trial." *Rochez Brothers v. Rhoades*, 527 F.2d 880, 891 (3rd Cir. 1975). However, Sec. 20(a) is remedial and to be construed liberally, *Harrison v. Dean Witter Reynolds, Inc.*, 974 F.2d 873, 880 (7th Cir. 1992), *cert. denied*, 113 S.Ct. 2994 (1993), *Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968)), "requiring only some sort of indirect means of discipline or influence short of actual direction to hold a control person liable." *Harrison, id.* That "'indirect means of discipline or influence' need not be stock ownership. It may arise from business relationships, interlocking directors, family relationships and a myriad of other factors." *Harriman*, 372 F.Supp. at 105. "Furthermore, a controlling person need not be the only person or entity with 'direct means of discipline or influence.'" *Harriman, id.*

1 SAA.³⁰ The most compatible test originated with the adoption by the federal Fifth Circuit of the
2 Rule 12b-2/405 definition of "control" as "the *possession*, direct or indirect, of the *power* to direct or
3 cause the direction of the management *and* policies of a person" (Italics added.) *Thompson*, 636
4 F.2d at 957-958; *Pharo v. Smith*, 621 F.2d 656, 670 (5th Cir. 1980), *aff'd on rehearing, remanded in*
5 *part on other grounds*, 625 F.2d 1226 (1980). The *Thompson* court opined that "[n]either this
6 definition nor the statute appears to require *participation* in the wrongful *transaction*," and affirmed
7 the control liability of a defendant who "had the requisite power to directly or indirectly control or
8 influence corporate policy." *Thompson, id.*, 636 F.2d at 958. (Italics added.)³¹ Revisiting this
9 standard over a decade later, the Fifth Circuit apparently interpreted *Thompson* to require "actual
10 power or influence over the controlled person." *Abbott v. Equity Group, Inc.*, 2 F.2d 613, 620 (5th
11 Cir. 1993), *cert. denied sub nom. Turnbull v. Home Ins. Co.*, 510 U.S. 1177 (1994). However, the
12 court declined to address whether there must be a showing of the actual *exercise* of that power over
13 the controlled person. *Abbott, id.* Under this test, therefore, liability accompanies possession of the
14 actual power to directly or indirectly control or influence the general affairs and policy of the
15 primary violator. See *Brown v. Mendel*, 864 F. Supp. 1138, 1145 (M. D. Ala. 1994) ("*Brown I*"),
16 *aff'd sub nom. Brown v. Enstar Group, Inc.*, 84 F.3d 393 (11th Cir. 1996) ("*Brown II*"), *cert. denied*,
17 117 S. Ct. 950 (1997); Bromberg & Lowenfels, *supra* at § 8.5 (834).

18
19
20 ³⁰ Two of these tests appear to be inapplicable in this matter. One is the *per se* control liability of securities
21 broker-dealer firms for conduct by their registered representatives within the firms' statutory control. See Bromberg
22 & Lowenfels, *supra* at § 8.5 (832), (833). Since no Respondent in this matter was registered as a dealer or salesman,
23 *Exhs. S-141, S-161 para, 20*, this test need not be addressed here. At the other extreme is the rigorous "culpable
24 participation" test that requires a *prima facie* showing of bad faith and inducement among the elements of control.
25 See Bromberg & Lowenfels, *supra* at § 8.5 (832) (837). As a minority view that fell into disfavor over the last
decade in all but the federal Third Circuit, *id.*, this test is the least favorable to the investor and therefore
incompatible with the investor protection purpose of the SAA. The plain meaning of Sec. 20(a) does not require
participation in the violative activity. See *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985), *cert. denied sub nom.*
Metge v. Bankers Trust Co., 474 U.S. 1057 (1986). Moreover, requiring actual participation in the violation creates
primary liability and would render meaningless the concept of secondary liability. See *Binder v. Gordian Securities,*
Inc., 742 F. Supp. 663, 668 (N.D. Ga. 1990).

26 ³¹ Following *Thompson*, a federal district court in that Circuit denied summary judgment in favor of an
alleged control person on grounds he was "fully capable of apprising himself of any ... business dealings" by a
primary violator as its vice-president and employee. *Binder*, 742 F.Supp. at 668.

1 Adding a second prong to this Fifth Circuit standard, the federal Eleventh Circuit recognized
2 a more rigorous test devised in a lower court opinion. Under this test, liability attaches to a person
3 possessing (1) "the *power* to control the *general* affairs" of the controlled person when it violated the
4 securities laws *and* (2) the "requisite *power* to directly or indirectly control or influence the *specific*
5 corporate policy which resulted in the primary liability." *Brown II.*, 84 F.3d at 396. (Italics added.)
6 See Bromberg & L. Lowenfels, *supra* at § 8.5 (835). In adopting this test, the Circuit court clarified
7 that "participation in the wrongful transaction" was *not* required, *Id.* at 397 n. 5, and declined to
8 address whether the first prong required "simply abstract power to control, or actual exercise of the
9 power to control." *Id.* at 397 n. 6. Apparently in reference to the second prong, however, the district
10 court opinion affirmed in *Brown II* had cited other district court authority in the Circuit that this
11 power need not be exercised; "possession of the power is enough to support a finding that the
12 defendant was a 'controlling person'". *Brown I*, 864 F.Supp. at 1144. Liability under this Eleventh
13 Circuit test therefore requires the possession of power to control *both* the general affairs of the
14 primary violator and its specific policy that resulted in the violation.

15 A third test is also two-pronged, requiring the *actual exercise* of control over the general
16 affairs of the primary violator *and* possession of power to control the specific violative activity
17 (whether or not exercised). See Bromberg & Lowenfels, *supra* at § 8.5 (836). Although this test is
18 now the most widely accepted among the federal circuits, Bromberg & Lowenfels, *supra* at § 8.5
19 (832), apparently including the Ninth Circuit,³² see *Kaplan v. Rose*, 49 F.3d 1363, 1382 (1994), *cert.*
20 *denied*, 116 S.Ct. 58 (1995), the additional evidentiary burden imposed by its first prong
21 significantly narrows the application of control liability and undercuts the SAA's protective purpose
22 by rewarding artful concealment behind "dummies" as well as negligent or reckless indifference.

23
24 ³² Since 1990 the Ninth Circuit has held that control liability does not require a showing of "culpable
25 participation" in the violation. See, e.g., *Paracor Finance, Inc. v. General Elec. Capital Corp.*, 79 F.3d 878, 889 (9th
26 Cir. 1996); *Hollinger*, 914 F.2d at 1575. Under its current test, this Circuit has clarified that a person is subject to
such liability "not because he controlled *those marketing* the investment contracts but because he was *one* of the
persons controlling *the issuer* of the investment contracts." *Arthur Children's Trust v. Keim*, 994 F.2d 1390, 1397 (9th
Cir. 1993). (Italics added.)

1 Ninth Circuit interpretations of federal securities law have not always comported with the
2 construction mandated by our legislature for the SAA.³³ In determining whether the an LLC
3 membership interest was an investment contract security under the SAA, Division One of our Court
4 of Appeals recently rejected a liability test followed by the Ninth Circuit in favor of a less
5 burdensome Fifth Circuit test because "it better protects the intent behind the securities laws and
6 takes account of the economic realities of the transaction." *Nutek Information Systems v. Arizona*
7 *Corp. Com'n*, 1998 WL 767176 at 5 (Ariz. Ct. App. 1998). Indeed, the Arizona Supreme Court itself
8 has declared that in interpreting the SAA it will deviate even from United States Supreme Court
9 interpretations of identical or similar federal securities statutes where "there is a good reason."
10 *Gunnison*, 127 Ariz. at 112-113, 618 P.2d at 606-607. Therefore, only the first two tests described
11 above will be applied herein to the record in this matter.

12 *Affirmative Defense to Control Liability*

13 Satisfying the control test subjects a control person to a rebuttable presumption of vicarious
14 liability under A.R.S. § 44-1999. Such liability can still be avoided under this statute, however, if
15 "the controlling person acted in good faith *and* did not directly or indirectly induce the act
16 underlying the action." (Italics added.) All but one federal Circuit shift the burden to prove this two-
17 pronged "good faith defense"³⁴ on the controlling person.³⁵ See Bromberg & Lowenfels, *supra* at §
18 8.5 (840), (842[4]). By prevailing on both prongs of this affirmative defense, an otherwise
19 controlling person sheds the vicarious liability imposed by operation of law for the primary violation
20

21 ³³ With no Arizona case law yet addressing A.R.S. § 44-1999, the Commission is not required to follow
22 Ninth Circuit or other federal decisional law in interpreting this statute. See *Laws 1996*, Ch. 197, § 11(C) (federal
23 court interpretations "may" be used as a guide). Indeed, the absence of Arizona decisional authority allows the
Commission to devise its own control standard under this statute in order to better serve the protective purpose of the
SAA mandated by *Laws 1951*, Ch. 18, § 20.

24 ³⁴ Both prongs are often referred to under the general rubric of the good faith defense. Bromberg &
Lowenfels, *supra* at § 8.5 (840).

25 ³⁵ "According to the statutory language, once the plaintiff establishes that the defendant is a 'controlling
26 person,' then the defendant bears the burden of proof to show his good faith." *Hollinger*, 914 F.2d at 1575. "Its effect
is to impose secondary or derivative liability on any person who controls a violator of the act or of any regulation
promulgated thereunder and who does not carry the day on the good faith defense provided therein." *Harriman*, 372
F. Supp. at 104.

1 by a otherwise controlled person.

2 The first "acted in good faith" prong requires a controlling person of a primary violator to
3 prove "his absence of scienter."³⁶ *Arthur Children's Trust v. Keim*, 994 F.2d 1390, 1398 (9th Cir.
4 1993). To the extent there is any *scienter* requirement for control liability, it arises only in the
5 context of this prong. *See Drobbin v. Nicolet Instrument Corp.*, 631 F.Supp. 860, 885 (S.D.N.Y.
6 1986). Beside this showing, the plain language of the prong also requires that a control person
7 "acted" without *scienter*. A control person must also affirmatively establish some supervisory
8 procedures or other precautionary measures appropriate under the circumstances. *See IX Loss &*
9 *Seligman, Securities Regulation*, 4472 (3d ed. 1992).

10 The "in good faith" *scienter* burden imposed on the controlling person by the first prong
11 should be construed to reflect essential differences between the SAA and federal law. Because Sec.
12 20(a) is a 1934 Act provision, this definition reflected the high level of *scienter* required by
13 decisional law³⁷ to prove a *primary* violation of the Sec. 10(b) antifraud provision in that law and
14 Rule 10b-5 thereunder. This primary violator *scienter* has evolved through case law to encompasses
15 a multitude of gradations shading from negligence through recklessness to specific intent. *See*
16 *Bromberg & Lowenfels, supra* at § 8.4 (501-504), (540). In *public enforcement* actions alleging Sec.
17 10(b) violation, negligence is sufficient "everywhere" to satisfy this requirement. *Bromberg &*
18 *Lowenfels, supra* at § 8.4 (501), (585[6]). Unlike this federal antifraud provision, *scienter* is not an
19 element of the primary violations of A.R.S. § 44-1991(2) and (3) alleged as predicates for control
20 liability in the instant matter. *See Gunnison*, 127 Ariz. at 113, 618 P.2d at 607; *Aaron*, 446 U.S. at
21 696, 100 S.Ct. at 1956. Therefore, the need to define the "good faith" prong as "absence of scienter"

23 ³⁶ "To establish the liability of a controlling person, the plaintiff does *not* have the burden of establishing
24 that person's scienter distinct from the controlled corporation's scienter." *Keim*, 994 F.2d at 1398. (Italics added.) A
25 controlling person is liable if the *primary* violator "intentionally or recklessly *permitted* the fraudulent marketing of
its securities." *Id.* (Italics added.) The controlling person then "has the burden of showing that he acted in good faith,
and so did not share in the scienter required for liability under Sec. 10(b)." *Kaplan v. Rose*, 49 F.3d 1363, 1382
(1994), *cert. denied*, 116 S.Ct. 58 (1995).

26 ³⁷ The United States Supreme Court imposed this requirement in *Ernst & Ernst v. Hochfelder*, 425 U.S.
185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976).

1 in regard to the last two subsections of the SAA anti-fraud provision should be interpreted to require
2 a controlling person to affirmatively prove the absence of all *scienter* including negligence, even
3 where no *scienter* need be shown for the primary violator.

4 The good faith defense *also* requires an affirmative showing under its second prong that the
5 control person "did not directly or indirectly"³⁸ induce the act underlying the action." *See Nordstrom,*
6 *Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1434 (9th Cir. 1995); *Zweig v. Hearst Corp.*, 521 F.2d
7 1129, 1132 (9th Cir. 1975), *cert. denied*, 423 U.S. 1025 (1975). In this matter, each specific violation
8 of A.R.S. § 44-1991 alleged against all primary Respondents is an "act" for the purpose of this
9 prong. The Ninth Circuit found inducement under this prong in the review and approval of
10 misleading public information releases by corporate directors and officers who believed in good
11 faith they were not perpetuating a fraud. *See Nordstrom, id.* Despite satisfying the good faith prong,
12 their inducement *alone* was sufficient to preclude invocation of the good faith defense. *See, id.*;
13 *Myzel v. Fields*, 386 F.2d 718, 738-739 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968) (good
14 faith inducement precludes defense). This construction comports with both the statutory language as
15 well as the strict liability nature of the primary SAA violations alleged as predicates for control
16 liability in the instant matter. Since "induce" means in part to "bring on or about, to affect, cause, to
17 influence to an act or course of conduct," *Black's Law Dictionary* 697 (5th ed. 1979),³⁹ it clearly
18 includes inaction as much as action. Therefore, the requisite showing under the prong should
19 encompass affirmative evidence where applicable that the control person "did not directly or
20 indirectly induce the act" by inaction.⁴⁰

21
22 ³⁸ Thus where primary liability arises from *indirectly* violating A.R.S. § 1991, a control person cannot avoid
23 derivative liability who has *indirectly* "induced" that indirect primary violation.

24 ³⁹ Compare with the legal dictionary definition of "participate" to mean in relevant part "to partake of;
experience in common with others; to have or enjoy a part or share in common with others." *Black's Law Dictionary*
1007 (5th ed. 1979).

25 ⁴⁰ Apparently combining the two prongs of the good faith defense, the Fifth Circuit held that "the burden on
the controlling person is to establish that he did not act recklessly in inducing, either by his action or his inaction, the
26 'act or acts constituting the violation' of 10b-5." *Thompson*, 636 F.2d at 960. The Circuit court further held that the
"degree" of such recklessness is less than the "severe form of recklessness" required for primary liability, and would
be whether the controlling person was "almost certainly aware of the danger." *Id.* at 960, 960 n. 28, 962 n. 33. Under

1 Insofar as the Respondents in this matter are burdened with asserting and proving this
2 affirmative defense by a preponderance of the evidence, its application to the hearing record will not
3 be addressed herein. If Respondents do assert and adduce evidence for this defense in their post-
4 hearing memo, the Division response memo will include a rebuttal.

5 **a. Controlling Persons of FISC**

6 Respondents Cheng, Yuen, Tokyo, Tam and Guo directly or indirectly controlled FISC,
7 individually and collectively.

8 ***Cheng***

9 All Respondents except Simmons stipulated that Cheng has been the president, a director
10 and one of two shareholders of FISC at all times relevant to this matter. *Exh. S-151, para. 9.*
11 Simmons has not contested these facts. Cheng is a British national residing in Hong Kong, *Exh. S-*
12 *151, para. 9*, and has been Executive Director of EVGL, just beneath Chairman Wing and deputy
13 Chairman Tak. *Exh. S-53.* Cheng has also been an EVGL director since May 2, 1994, *Exh. S-162b*,
14 apparently one of only two. *Exh. S-162c.* EVGL took over direct ownership of EVFL as its sole
15 shareholder on August 1, 1997. Percy Lung, the chief dealer at EVFL's Macau office testified that
16 Cheng was a director "in the company" who was "responsible for accounting" and "paying us"
17 salaries. *Exh. S-82, pp. 31-33.* This was unchanged since before "my company told me to go to -- to
18 move to Macau" from Hong Kong in 1994 where "we set up an office" when Hong Kong passed a
19 foreign currencies trading ordinance⁴¹ restricting EVFL from doing business with "customers in
20 Hong Kong" or placing orders with Hong Kong banks. *Exh. S-82, pp. 21-22, 29, 31, 45-46.*

21 In 1994, a year before FISC was incorporated, Cheng apparently became a player in Tokyo
22

23
24 this interpretation of the defense, negligence would apparently satisfy the good faith prong and sustain the defense
25 even if the controlling person induced the primary violation by action or inaction. However, the plain language of the
26 statute favors the opposing interpretation adopted by other circuits that good faith inducement precludes the defense.
See *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1434 (9th Cir. 1995); *Myzel*, 386 F.2d at 738-739 (8th Cir.).
The *Thompson* court itself acknowledged that under a literal reading of the statute an indirect good faith inducement
would give rise to liability. *Thompson, id.* at 960 n. 27.

⁴¹ Leveraged Foreign Exchange Trading Ordinance (53 of 1994), Hong Kong, enacted 23 June 1994.

1 as well as EVGL when DPS Global Management Ltd. ("DPS") purchased shares from Tokyo half
2 owner and director Hong Tai Sum a/k/a Tai Sum Hung.⁴² *H.T.*, pp. 1561-62; *Exhs. S-42; S-67b; S-*
3 *72b*. The "identifying number" of the Tokyo stock transferee shown on the share certificate receipt is
4 Cheng's Hong Kong identity card number,⁴³ *H.T.*, pp. 2074-76, *Exhs. S-72a, S-161, para. 9*,
5 signifying that the stock was assigned to Cheng as owner of DPS. *H.T.*, p. 2076. Half of Tokyo
6 stock is now owned by DPS. *Exh. S-37a, pp. 17-18*. With his beachhead secured at Tokyo, Cheng
7 moved to expand outward from San Francisco.

8 Tam testified that FISC came into being because "a couple of investors interested having a
9 business set up. And the same type business what we do in San Francisco. And they want to invest
10 and they asked us to try to manage it for them to make a profit." *Exh. S-37a, p. 19*. Cheng and Yuen
11 were "interested to own investment service company. So we promise to help them to build up the
12 business office here in Phoenix because we feel that it is a potential market here in Phoenix. And
13 they agreed that there is a potential market. So they invest the money and set up a company." *Exh. S-*
14 *37a, p. 20*. Cheng participated in the incorporation of FISC in August 1995, *Exhs. S-52, S-69*, and its
15 owners provided \$100,000 for start-up costs. *Exh. S-37a, pp. 22, 76-77*. The Phoenix office lease
16 was signed on September 13, 1995, *H.T.*, p. 2077, and FISC opened for business in April 1996. *Exh.*
17 *S-37a, p. 33*. This start-up capital was not enough. EVFL admits that Cheng and Scott Yuen,⁴⁴ the
18 husband of Jean Yuen, provided \$145,000 in "loans to FISC" in 1996 alone from an EVFL trading
19 account held jointly by Cheng and Scott Yuen. *Exh. S-184*. When funds were needed to support the
20 operation of FISC, Cheng and Scott Yuen "frequently asked EVFL to wire transfer funds from their
21 trading accounts to FISC's Wells Fargo⁴⁵ bank account." *Exh. S-184*. Virtually all of the deposits
22

23 ⁴² Tai Sum Hung was shown as a Tokyo director along with Guo on Tokyo's 1992 corporate filing in
24 California. *Exh. S-67b*. Tokyo's 1994 tax returns reported Tai Sum Hung as a 50% "foreign" shareholder whose
citizenship and principal place of business were in Hong Kong. *Exh. S-42*.

25 ⁴³ This receipt apparently bears the witnessing signature of Yam Cho Hung, *H.T.*, pp. 1562-63, who is the
same person as Alwin Yam, *H.T.*, p. 3194, the administrator of EVGL. *Exh. S-82, p. 46*.

26 ⁴⁴ The Check and Deposit Register for FISC's Wells Fargo account shows that check no. 95 was issued on
December 22, 1995 to Scott Yuen For \$420.08 in payment of "reimburse trip exp." *Exh. R-79*.

⁴⁵ FISC had one general operating account at Wells Fargo Bank. *Exh. S-37a, p. 74*.

1 into FISC's account in 1996 came from margin withdrawals from their joint EVFL account. *Exh. S-*
2 *184.*

3 Tam consulted with the FISC owners on major decisions. *Exh. S-37a, p. 64.* After being
4 informed by Tam, the owners made the decision not to renew the contract with Dionisio, Cho's
5 predecessor as FISC marketing manager. *Exh. S-37a, pp. 64-65.* Tam also consulted with them
6 about the hiring of Cho. *Exh. S-37a, p. 65.* Cho testified that Tam was communicating with the
7 owners. *Exh. S-35a, p. 25.*

8 Q. Did he ever indicate that he was consulting or advising them in regard to
9 overall policy or procedures or practices at FISC?

10 A. I think he did mention that. Of course, they're worried about how the
11 business is doing, so basically up to that extent, how's business doing.

12 *Exh. S-35a, p. 26.*

13 Cheng was a controlling person of FISC, individually and collectively with Yuen, Tokyo,
14 Tam and Guo. As officer, director and half owner of FISC, and through DPS' half ownership of
15 FISC's contract manager Tokyo, Cheng possessed the actual power to directly or indirectly control
16 or influence the general affairs and policy of FISC. Moreover, by consulting with Tam about major
17 decisions affecting FISC and approving them, he actually exercised that power over FISC.

18 **Yuen**

19 All Respondents except Simmons stipulated that Yuen has been the secretary, treasurer,
20 director and one of two shareholders of FISC at all times relevant to this matter. *Exh. S-151, para.*
21 *10.* Simmons has not contested these facts. Yuen is a naturalized U.S. citizen born in Shanghai,
22 China. *Exh. S-81, p. 10.* She attended City College in San Francisco for two years and was the
23 manager of the Yuen Garment Factory in California until 1995. *Exh. S-81, pp. 13, 14.* Her husband
24 owns an export business in San Francisco. *Exh. S-81, p. 40.* Respondent Guo is her husband's
25 cousin. *Exh. S-81, p. 39.* She traveled to Hong Kong in 1995. *Exh. S-81, p. 54.* She met Respondents
26 Wing and Tak in Hong Kong. *Exh. S-81, pp. 54-56.* She met Respondent Sharma in San Francisco
before signing any papers for FISC. *Exh. S-81, pp. 56-57.* Respondent Tam was a friend of Yuen's

1 husband. *Exh. S-81, p. 30.*

2 Tam testified that FISC came into being because "a couple of investors interested having a
3 business set up. And the same type business what we do in San Francisco. And they want to invest
4 and they asked us to try to manage it for them to make a profit." *Exh. S-37a, p. 19.* Yuen and Cheng
5 were "interested to own investment service company. So we promise to help them to build up the
6 business office here in Phoenix because we feel that it is a potential market here in Phoenix. And
7 they agreed that there is a potential market. So they invest the money and set up a company." *Exh. S-*
8 *37a, p. 20.* Yuen and Cheng were the only shareholders of FISC, each holding half of its stock.
9 *Exhs. S-37a, p. 21; S-68.* They provided the \$100,000 start-up costs for FISC. *Exh. S-37a, pp. 22,*
10 *76-77.* This was not enough. EVFL admits that Cheng and Scott Yuen, the husband of Jean Yuen,
11 provided \$145,000 in "loans to FISC" in 1996 alone from an EVFL trading account held jointly by
12 Cheng and Scott Yuen. *Exh. S-184.* When funds were needed to support the operation of FISC,
13 Cheng and Scott Yuen "frequently asked EVFL to wire transfer funds from their trading accounts to
14 FISC's Wells Fargo bank account." *Exh. S-184.* Virtually all of the deposits into FISC's account in
15 1996 came from margin withdrawals from their joint account. *Exh. S-184.*

16 When Tam had FISC documents for Yuen to sign, he telephoned her to come to the Tokyo
17 office. *Exh. S-46.* She knew Tam worked for Tokyo as well as FISC. *Exh. S-81, p. 45-46.* She
18 admitted she signed the articles of incorporation⁴⁶ and federal or state tax returns. *Exh. S-81, p. 21.*
19 A signature for Yuen appears above her name executing the FISC Articles of Incorporation as
20 "Incorporator/Secretary," *Exhs. S-52; S-76;* the incorporating Certificate of Disclosure to the
21 Commission as FISC "Incorporator," *Exh. S-76;* a letter of transmittal to the Commission dated
22 August 8, 1995 as FISC "Secretary," *Exh. S-76;* the Waiver of Notice of the First Meeting of the
23 Incorporators as FISC "Incorporator," *Exh. S-52;* the Minutes of the First Meeting of the

24
25 ⁴⁶ Grace Chen, CPA, prepared the incorporation filings and related company minutes in Arizona and mailed
26 them to Tam who procured the necessary signatures from Yuen and returned them to Chen for filing and
safekeeping. *H.T., pp. 1664-67, 1671, 1673, 1689' 1694-95; Exh. S-76.* She also sent subsequent ACC Annual
Report forms to Tam for Yuen's signature. *H.T., p. 1677, 1680, 1689.*

1 Incorporators as FISC "Secretary," *Exh. S-52*; the Waiver of Notice of the First Meeting of the
2 Board of Directors as FISC "Director," *Exh. S-52*; the Minutes of the First Meeting of the Board of
3 Directors as FISC "Secretary," *Exh. S-52*; the FISC Annual Report for 1995 as "Secretary," *Exh. S-*
4 *77*; and the FISC Annual Report for 1996 as "Treasurer." *Exh. S-78.*⁴⁷ Yuen apparently signed the
5 agreement between FISC and Tokyo dated January 1, 1997, *H.T., p. 1565, Exh. S-70*, as well as the
6 "Amendment to Agreement" dated December 17, 1997 that terminated "all agreements between"
7 FISC and EVFL. *H.T., p. 1534; Exh. S-73.*

8 Tam never told her she did not have to read the documents. *Exh. S-81, p. 49.* She never told
9 him that she didn't need to look at them. *Exh. S-81, pp. 48-49.* Yuen admitted she knew when she
10 began signing papers filed with the Commission that she appeared thereon as Secretary of FISC.
11 *Exh. S-81, p. 32.* She knew FISC was a business operating from a Phoenix office. *Exh. S-81, pp. 34,*
12 *36.* She never resigned as an FISC officer. *Exh. S-81, p. 33.*

13 Tam consulted with the FISC owners on major decisions. *Exh. S-37a, p. 64.* After being
14 informed by Tam, the owners made the decision not to renew the contract with Dionisio, Cho's
15 predecessor as FISC marketing manager. *Exh. S-37a, pp. 64-65.* Tam also consulted with them
16 about the hiring of Cho. *Exh. S-37a, p. 65.* Tam indicated to Cho that he was communicating with
17 the owners. *Exh. S-35a, p. 25.*

18 Q. Did he ever indicate that he was consulting or advising them in regard to
19 overall policy or procedures or practices at FISC?

20 A. I think he did mention that. Of course, they're worried about how the
21 business is doing, so basically up to that extent, how's business doing.

22 *Exh. S-35a, p. 26.*

23 Yuen was a controlling person of FISC, individually and collectively with Cheng, Tokyo,
24 Tam and Guo. As officer, director and half owner of FISC, she possessed the actual power to

25 ⁴⁷ Division investigator Michael Smedinghoff testified that the signatures above Yuen's name are similar on
26 the Waiver of Notice of the First Meeting of the Incorporators, the Minutes of the First Meeting of the Incorporators,
the Minutes of the First Meeting of the Board of Directors, and FISC's 1995 and 1996 Annual Reports. *H.T., pp.*
1484-92.

1 directly or indirectly control or influence the general affairs and policy of FISC. Moreover, by
2 consulting with Tam about major decisions affecting FISC and approving them, she actually
3 exercised that power over FISC.

4 *Tokyo*

5 Tokyo was incorporated in California on November 21, 1991 and started its "investment"
6 business on March 1, 1992. *Exhs. S-42; S-67a; S-67b*. While she was employed by FISC in 1996,
7 Tam told Mary Goss that Tokyo "was a branch of Eastern Vanguard." *H.T., p. 1713*. Tokyo
8 provided to the FISC's prospective landlord a letter of reference from Tokyo's banker in San
9 Francisco, *Exh. S-41*, as well as its federal and state tax returns for 1994. *Exh. S-42*.

10 Pursuant to an agreement between Tokyo and FISC dated January 1, 1997, Tokyo received
11 \$3 per "order settlement" from FISC plus housing and traveling expenses for Tam in return for
12 providing "management consulting services" to FISC and handling "settlement" of FISC orders.
13 *H.T., pp. 1563-65; Exhs. S-37a, pp. 10-11; S-70*. Tokyo was in the same business as FISC, *Exh. 37a*,
14 *p. 19*, and managed FISC from its inception until its closing. From March 1996 until January 1997,
15 Garrett Tsang was on assignment from Tokyo to train and supervise FISC operations personnel but
16 was never an FISC employee nor received any FISC paycheck. *Exh. S-37a, p. 32*. The January 1997
17 training class at FISC was taught by Tony Taniguchi who was also a Tokyo employee. *Exh. S-36a*,
18 *p. 32*. Tokyo twice loaned \$10,000 to FISC to keep FISC in business. *Exhs. S-37a, pp. 75-78*. The
19 fixed employee compensation Tam received from Tokyo included his work for FISC. *Exhs. S-37a*,
20 *p. 79*.

21 Half of Tokyo stock is owned by "DPS Global Corporation," a Hong Kong corporation. *Exh.*
22 *S-37a, pp. 17-18*. DPS Global Management Ltd. ("DPS") purchased its equity interest in Tokyo in
23 1994, a year before FISC was incorporated. *Exhs. S-72a; 72b*. The "identifying number" of the
24 Tokyo stock transferee shown on the share certificate receipt is the Hong Kong identity card number
25 for Cheng, *H.T., pp. 2074-76, Exh. S-72a*, signifying that the stock was assigned to Cheng as owner
26 of DPS. *H.T., p. 2076*. Acting through DPS, Cheng acquired a half interest in Tokyo a year before

1 he established FISC with Yuen.

2 Cho came directly to FISC from the marketing department at Tokyo, where he had been
3 employed since May, 1995. *Exh. S-35a, pp. 57-58*. His duties at Tokyo were the same as at FISC,
4 except that he was under a marketing manager at Tokyo as well as Tam. *Exh. S-35a, pp. 59-60*. "My
5 job was to generate business by doing the same thing that I was doing in San Francisco. Basically a
6 carbon copy of San Francisco," Cho testified. *H.T., p. 2156*.

7 Q. Did Mr. Tam ever explain the relationship between Tokyo International and
8 FISC to you, if any?

9 A. The way he described it to me was basically, just basically the same office.
10 That's how he described it to me, under his management.

11 *Exh. S-35a, p. 94*. The training materials used at FISC were the same used by Tokyo. *H.T.,*
12 *p. 2975*. The FISC "Foreign Exchange Services" brochure and the "Addendum" to the EVFL
13 Customer's Agreement were substantially the same as that used by Tokyo. *H.T. pp. 2816, 2894;*
14 *Exhs. S-43; S-44*. The "standard" FISC introductory letter provided to traders for soliciting investors
15 was the same as that used by Tokyo. *H.T., pp. 2794, 2976-77; Exh. S-99*.

16 As manager of FISC, Tokyo was a controlling person by itself and collectively with Cheng,
17 Yuen, Tam and Guo.

18 **Tam**

19 Respondent Tam has been an employee and general manager of Tokyo at all times relevant
20 to this matter. *Exhs. S-37A, pp. 11-12; S-151, para. 12*. He is a U.S. citizen born in Hong Kong. *Exh.*
21 *S-37, p. 7*. Tam was "in charge of" the FISC Phoenix office as well as the San Francisco Tokyo
22 office. *H.T., pp. 1706, 2153; Exh. S-36A, p. 18; S-62, p. 4; S-66*. Tam helped incorporate FISC.
23 *H.T., pp. 1662, 1665-69, 1671, 1673; Exhs. S-37A, p. 21; S-68; S-69*. He worked with FISC from its
24 beginning in Phoenix. *Exh. S-37a, p. 26*. He monitored all the administration, expense payments and
25 internal staffing for FISC. *Exh. S-37a, pp. 27, 63*. He delivered paychecks to FISC. *Exh. S-36a, p.*
26 *90*. He signed the FISC paychecks for Cho. *Exh. S-35a, p. 94*.

He supervised the FISC operations clerks. *Exh. S-37a, pp. 29-30*. He admitted he had

1 authority to make some decisions for FISC. *Exhs. S-37a, p. 64.*

2 Q. So is it fair to say that you do not merely recommend to the owners that
3 certain things are done but you actually make decisions as to how they will be done?

4 A. My decision without consulting with the owner is on day-to-day operations.
5 If a major decision, I would consult with the owners.

6 Q. In regard to the marketing and training activities at FISC, did Mr. Dionisio
7 report to you or did he report to the owners?

8 A. He report to me and recommendations, and I will have the decision that
9 according to expenses that are needed, I will have to make the decision.

10 Q. Who made the decision to not renew the contract with Mr. Dionisio?

11 A. I have to inform the owner and they decided it's not worth it to continue the
12 relationship.

13 Q. And who then informed Mr. Dionisio that --

14 A. I did.

15 Q. In relation to Mr. Stember, who handled the discussions with him concerning
16 his marketing proposals?

17 A. Mr. Dionisio and myself.

18 Q. And when the decision was made to not pursue any further relationship with
19 Mr. Stember, who informed Mr. Stember of that?

20 A. Myself.

21 Q. In regard to Mr. Cho, who hired him?

22 A. I did.

23 Q. And was that made as a result of consultation with the owners or on the basis
24 of your own decision?

25 A. I have consult with the investor/owner.

26 Q. And Mr. Simmon, did you also hire him on the basis of consultation?

A. On the recommendation of Mr. Cho.

Exhs. S-37a, pp.64-65. Tam offered Cho the position of FISC marketing manager. Exh. S-35a, p. 67. Cho went to Tam if he had a question raised by a trader that had something to do with FISC. Exh. S-35a, p. 17. Cho placed newspaper advertisements for trader applicants when Tam ordered him to. Exh. S-35a, p. 17. During the time Cho worked at FISC, Tam was his "only superior."

Q. Did you consult with him regularly?

A. Yes.

Q. Was he aware of how you were performing your duties?

A. Everything.

Q. Did he give you direction?

A. Yes.

Q. So, is it fair to say then throughout the period that you were employed by FISC, the only person that you took orders from or communicated with for direction was with Mr. Tam?

A. Correct, absolutely.

Q. Did Mr. Tam ever indicate to you that he was communicating with the owners of FISC?

1 A. Yes.
2 Q. Did he ever indicate to you that he was consulting with them as to decisions
3 for FISC?
4 A. What do you mean by decisions?
5 Q. Whether employment decisions, any kind of business policy, practices.
6 A. What I understand was Mr. Tam is the one who made those decisions on
7 behalf of the owners. They trusted him 110 percent.
8 Q. Did Mr. Tam ever indicate to you that he was advising and consulting with
9 the owners as to what decisions he was making?
10 A. Not in regard to daily activities. I don't recall.
11 Q. Did he ever indicate that he was consulting or advising them in regard to
12 overall policy or procedures or practices at FISC?
13 A. I think he did mention that. Of course, they're worried about how the
14 business is doing, so basically up to that extent, how's business doing.

15 *Exh. S-35a, pp. 23-26. Cho talked with Tam before making every decision. H.T., pp. 2157-*
16 *58. "I never did anything without consulting Mr. Tam. I followed his instructions." H.T., p. 2158.*

17 Q. Did Mr. Tam monitor your activities closely?
18 A. Yes.
19 Q. Was he aware of what you were doing on a day-to-day basis?
20 A. I don't know about daily basis, but he knew everything that was going on in
21 the office.
22 Q. And would it be fair to say that he had overall control of the management of
23 the office?
24 A. Of course.
25 Q. Subject, perhaps, to whoever owned the company?
26 A. Correct.
27 Q. And it's fair to say that he was as aware of the marketing department's
28 activities as her was of the operations department activities?
29 A. Yes.
30 Q. Did you report to him on a daily basis?
31 A. Yes.
32 Q. Did you report to anybody else?
33 A. No.

34 *Exh. S-351, pp. 94-95. As marketing manager for FISC, Simmons also reported to Tam and*
35 *went to him with any question about a matter raised by an FISC client. Exh. S-36a, pp. 18, 90.*
36 *Simmons' dependence on Tam for direction is clearly reflected in the audiotape and partial transcript*
37 *of the Shumways' meeting with Simmons at the FISC office on November 21, 1997. Exhs. S-139a;*
38 *S-139b; S-160. During this meeting, Simmons telephoned Tam for answers to the Shumways'*
39 *questions about their account. Exhs. S-139a; S-160, pp. 1, 4. Simmons told them that Tam was "the*
40 *guy at the top." Exhs. S-139a; S-160, p. 2. Written complaints received by Simmons from investors*
41 *were forwarded to him. Exh. S-62, pp. 2-4.*

1 Corporations must act through agents. *E.g., Braswell v. United States*, 487 U.S. 99, 109, 108
2 S. Ct. 2284, 2290, 101 L.Ed.2d 98 (1988). FISC was under management by Tokyo through its
3 employee Tam, who was a controlling person of FISC individually and collectively with Cheng,
4 Yuen, Tokyo and Guo.

5 ***Guo***

6 All Respondents except Simmons stipulated that Guo has been Chief Executive Officer,
7 Secretary, Chief Financial Officer and a Director of Tokyo. *Exh. S-151, para. 13*. Simmons has not
8 contested these facts. Guo signed the 1992 and 1997 "Statement" filings by Tokyo with the
9 California Secretary of State. *H.T., pp. 1556-57; Exhs. S-67b; S-67c*. He also signed the "Fictitious
10 Business Name Statement" filings by Tokyo with the City and County of San Francisco. *Exhs. S-*
11 *71a; S-71b*. Guo owns half of Tokyo stock, *Exhs. S-37a, pp. 17-18; S-42*, and devotes 100% of his
12 time to the business of Tokyo. *Exh. S-42*. In 1994, Guo was the only Tokyo officer to receive
13 compensation. *Exh. S-42*. When Cho began his employment at Tokyo in 1995, Tam and the
14 marketing manager told him "a local businessman was the owner." *H.T. p. 2721*.

15 Corporations must act through agents. *E.g., Braswell v. United States*, 487 U.S. 99, 109, 108
16 S. Ct. 2284, 2290, 101 L.Ed.2d 98 (1988). FISC was under management by Tokyo, and as a Tokyo
17 principal, officer and director, Guo was a controlling person of FISC individually and collectively
18 with Cheng, Yuen, Tokyo and Tam.

19 **b. Controlling Persons of EVFL**

20 Respondents Sharma, EVGL, Wing and Tak directly or indirectly controlled EVFL,
21 individually and collectively.

22 ***Sharma***

23 Percy Lung, chief dealer at the EVFL office in Macau since it opened in 1994, testified that
24 Sharma was connected with EVFL and had "his own room" in "our office" in Hong Kong. *Exh. S-*
25 *82, pp. 29, 37-38*. "Firgal Consultants Limited," a British Virgin Islands "International Business
26 Company" originally incorporated in September, 1993, was renamed Eastern Vanguard Forex Ltd.

1 on August 9, 1994, *Exh. S-49*, the same day that Sharma became its Director.⁴⁸ *Exh. S-183*. All
2 Respondents except Simmons stipulate that Sharma was a Director of EVFL until August 1, 1997,
3 *Exh. S-151, para. 4*, and was so listed on its "Company Profile" brochure under "Executive
4 Officers". *Exh. S-53*. Simmons has not contested these facts. On behalf of EVFL, Sharma signed the
5 agreement between it and FISC dated January 1, 1997. *H.T., p. 1531; Exh. S-73*. The EVFL
6 Customer Agreements signed by investors Alan and Deborah Davis, F. Dean and Melba Davis, and
7 Michael Noriega, are executed "For and on behalf of" EVFL by an "Authorized Signature" that
8 appears to be Sharma. *H.T., pp. 1531-32; Exhs. S-89; S-109; S-140*. He was EVFL's sole
9 shareholder until August 1, 1997, when he resigned as EVFL Director and all his shares were
10 transferred to EVGL. *Exhs. S-74a, S-74b; S-74c; S-74e*. He had signatory power on all of EVFL's
11 bank accounts, along with Tak, *Exh. S-183*, and investor withdrawal of funds from EVFL trading
12 accounts required their signed written authorization to EVFL's California bank. *Exhs. S-151, para.*
13 *15; S-46; S-54; S-55; S-60*. He was not replaced as an EVFL account signatory until sometime in
14 October 1997, *Exh. S-183*, over two months after he officially resigned as Director and transferred
15 his shares to EVGL.

16 From 1994 until August 1, 1997, Sharma acted as a "dummy" nominee director and
17 shareholder on behalf of EVGL and its principals, officers, directors and controlling persons. He
18 was a controlling person of EVFL at all relevant times, individually and collectively with EVGL,
19 Wing and Tak.

20 **EVGL**

21 The EVFL "Company Profile" brochure describes EVFL as "A Member of the Eastern
22 Vanguard Group," lists EVFL under the "Eastern Vanguard Group of Companies,"⁴⁹ and depicts the
23

24 ⁴⁸ Apparently, Sharma was the sole Director of EVFL, which is permitted under its Articles of Association
25 at paragraph 84. *Exh. S-49*. No EVFL corporate officers have been disclosed in this matter, and paragraphs 93 and
26 115 of the company Articles of Association do not mandate the appointment of officers. *Exh. S-49*. However,
paragraph 93 of the Articles does mandate that the company's business and affairs "shall be managed by the
directors." *Exh. S-49*.

⁴⁹ This list also includes Eastern International (Holdings) Ltd. ("Eastern International") and Eastern Trading

1 "Eastern Vanguard Group" as a "Member of the Eastern Vanguard Group Ltd. (BVI)." *Exh. S-53*.
2 EVGL was incorporated in the British Virgin Islands as an "International Business Company" on
3 March 16, 1994. *Exh. S-48*. Since then it has issued only one share of stock in the form of a "bearer"
4 stock certificate⁵⁰ dated May 1, 1994. *Exh. S-162a*. EVGL has not disclosed in this matter the
5 identity of the holder or custodian of the bearer certificate.

6 Respondent Wing has been the Chairman⁵¹ of EVGL at all relevant times. *Exh. S-161, para.*
7 5. Respondent Tak has been EVGL deputy Chairman at all relevant times, *Exh. S-161, para. 6*, and
8 EVGL Secretary since August 1, 1994. *H.T., pp. 1542-44; Exh. S-162d*.⁵² Respondent Cheng is
9 EVGL's Executive Director. *Exh. S-53*. Cheng and Wing have also been the only two directors⁵³ of
10 EVGL since May 2, 1994, the day after EVGL's single bearer share was issued. *H.T., pp. 1541-42;*
11 *Exhs S-162a; S-162b; S-162c*. Percy Lung, chief dealer at the EVFL office in Macau since it opened
12 in 1994, testified that Wing, Tak and Cheng have been his "superiors" since before "my company
13 told me to go to -- to move to Macau" where "we set up an office" that year when Hong Kong
14 passed a foreign currencies trading ordinance restricting EVFL from doing business with "customers
15 in Hong Kong" or placing orders with Hong Kong banks.⁵⁴ *Exh. S-82, pp. 11, 21-22, 29, 31, 34, 38,*
16 *45-46*. According to Lung, "the company had a meeting and the Board of directors had the decision
17
18

(HK) Ltd. ("Eastern Trading"). *Exh. S-53*. Since its renaming in 1993, Respondents Cheng and Tak have been the
19 directors and shareholders of Eastern International, a Hong Kong company, each with one share. *H.T., pp. 2053-*
20 *2059; Exh. S-63*. Since its renaming in 1994, Respondent Wing and Hung Tai Sum have been directors and
21 shareholders of Eastern Trading, a Hong Kong company, Wing with 999,999 shares and Hung Tai Sum with one
22 share. *H.T., pp. 2059-69; Exh. S-50*. The Hong Kong address shown for Hung Tai Sum in the *Exh. S-50* public
23 filings is identical to that shown for co-owner Tai Sum Hung on Tokyo's 1994 tax returns. *Exh. S-42*. Hung Tai Sum
24 is shown as the seller of Tokyo stock on *Exh. S-72b*.

25 ⁵⁰ Issuance of bearer shares is authorized by EVGL's Memorandum of Association at paragraph 7, and by
its Articles of Association at paragraphs 2 and 4. *Exh. S-48*.

26 ⁵¹ Paragraph 69 of EVGL's Articles of Association provides that the "directors may elect a chairman of their
meetings and determine the period for which he is to hold office." *Exh. S-48*.

⁵² *Exh. S-162d* shows the name of "SUEN Peter," but the Hong Kong identity card number also shown for
him is identical to that stipulated for Respondent Tak by all Respondents except Simmons. *H.T., pp. 1542-44; Exh.*
S-151, para. 6.

⁵³ EVGL's Articles of Association mandates at paragraph 61 that the company's business "shall be
managed" by the directors. *Exh. S-48*.

⁵⁴ Leveraged Foreign Exchange Trading Ordinance (53 of 1994), Hong Kong, enacted 23 June 1994.

1 that we should move to Macau." *Exh. S-82, p. 31*. Although Lung moved to Macau where he heads
2 five dealers for EVFL, all his "superiors" are still in Hong Kong. *Exh. S-82, p. 34*.

3 On August 9, 1994, a company named "Eastern Vanguard Forex Limited" was incorporated
4 under Hong Kong's Companies Ordinance, *Exh. S-64*, the same day that "Firgal Consultants
5 Limited," an "International Business Company" incorporated in the British Virgin Islands almost a
6 year earlier, was renamed Eastern Vanguard Forex Ltd., *H.T., pp. 2071-72, Exh. S-49*, and Sharma
7 made its Director⁵⁵ and sole shareholder. *Exhs. S-74b; S-183*. Lung knew Sharma but never met him
8 in Macau, and testified he knew Sharma was connected with EVFL because Sharma had "his own
9 room" where he "worked in our office" in Hong Kong. *Exh. S-82, pp. 37-38*.

10 EVGL directors Cheng and Wing became the two directors of the Hong Kong Eastern
11 Vanguard Forex Limited, with Cheng as its corporate secretary. *H.T., pp. 2072-73; Exh. S-64*.
12 Shortly afterward, on October 18, 1994, this Hong Kong company changed its name to "Eastern
13 Traders (HK) Ltd." by "Special Resolution" passed at an "Extraordinary General Meeting of the
14 Company" held in Hong Kong. *H.T., pp. 2073-74; Exh. S-64*. Within less than a year, Cheng also
15 became president and a director of FISC as well as one of its two shareholders. *Exh. S-151, para. 9*.

16 Alwin Yam ("Yam")⁵⁶ is the "administrator" of EVGL, who Lung met in Hong Kong, *Exh.*
17 *S-82, p. 46*, and "Chief Administrator" for EVFL. *Exhs. S-53; S-183; S-184*. He replaced Sharma as
18 EVFL Director on August 1, 1997. *Exhs. S-74c; S-74d*. He later replaced Sharma as a signatory on
19 all EVFL bank accounts sometime in October, 1997. *Exh. S-183*.

20 EVGL became the sole shareholder of EVFL effective August 1, 1997. *Exhs. S-74a; S-74b;*
21 *S-74e*. EVGL chairman Wing executed the EVFL "Resolution" appointing EVGL administrator
22 Yam as EVFL director in place of Sharma, *Exh. S-74c*, and apparently executed as well the EVFL

23
24 ⁵⁵ Apparently, Sharma was the sole Director of EVFL, which is permitted under its Articles of Association
25 at paragraph 84. *Exh. S-49*. No EVFL corporate officers have been disclosed in this matter, and paragraphs 93 and
26 115 of the company Articles of Association do not mandate the appointment of officers. *Exh. S-49*. However,
paragraph 93 of the Articles does mandate that the company's business and affairs "shall be managed by the
directors." *Exh. S-49*.

⁵⁶ Alwin Yam is the same person as Yam Cho Hung. *H.T., p. 3194*.

1 "Memorandum" authorizing the share transfer. *H.T.*, p. 1526; *Exh. S-74a*. Yam admitted that EVGL
2 "is a holding company that holds EVFL." *Exh. S-184*.

3 Tam told FISC dealing clerk Mary Goss in 1996 that "Eastern Vanguard was looking to
4 open some more locations in the United States, and they were based out of Hong Kong." He said
5 "they had wanted to open a location in either Phoenix or Dallas, Texas, but being that Phoenix was
6 closer for commute purposes, he decided to do that. And he also went into how they had one in
7 Seattle but that that was closed down before." *H.T.*, p. 1717. About the beginning of May, 1996,
8 Tam told Goss that "our boss" from Hong Kong was coming to the FISC office. *H.T.*, pp. 1744,
9 1757. Goss recalled meeting an "oriental gentleman" at the office who spoke a "little bit" of English,
10 "showed pictures of the other Eastern Vanguard locations and said that this was one of our prettiest
11 areas." *H.T.*, p. 1745. Another visitor came to the office later from Eastern Vanguard in Hong Kong
12 who she was told was "important." *H.T.*, p. 1746. Responding to her concern about the future of the
13 FISC office, Tam said that "his bosses" at Eastern Vanguard would make any decision to close it
14 down. *H.T.*, p. 1748.

15 Chief EVFL dealer Lung testified about his "superiors" in Hong Kong -- Wing, Tak and
16 Cheng -- that "they travel all over the world." *Exh. S-82*, p. 34. Cho testified that while he worked at
17 Tokyo in 1995 and 1996, Wing and Tak visited the Tokyo office in San Francisco several times --
18 once with their "secretary" -- to "check the office and their other offices that they were doing
19 business with in the United States." *H.T.*, pp. 2723-24. Wing usually "visits all the offices." *H.T.*, p.
20 2815. Cho heard of offices in Miami, San Diego and Los Angeles. *H.T.*, p. 2725. During their visits
21 to Tokyo, Wing and Tak "spent all of their time" with Tam. *H.T.*, p. 2725. Cho understood that
22 Wing "was kind of in charge or had a big say" in regard to the FISC and Tokyo offices. *H.T.*, p.
23 2814.

24 Q. And where did you get that understanding from?

25 A. Mr. Tam call him big boss to me. Big boss is coming in town. And every time he
26 gets in town, he's always with him and giving him all the attention in the world.

H.T., p. 2815. Wing visited the FISC office in 1996 shortly after it opened, where he met and

1 spoke with Dan Hoesch. *H.T.*, p. 2469. Hoesch knew him to be the chairman of the board and boss
2 of Eastern Vanguard. *H.T.*, pp. 2469-70. EVGL chairman Wing again visited the FISC office with
3 Tam in the spring of 1997 while Cho was marketing manager and stayed for two to four days at the
4 Phoenix "staff apartment" where Cho lived rent-free. *H.T.*, pp. 2809, 2811; *Exh. S-35a*, pp. 31, 39,
5 40, 49-50, 51. Wing and Tam came into the office each of these days but one and Wing asked Cho
6 questions about how business was going at FISC. *Exh. S-35a*, p. 40. Wing "said specifically that
7 FISC do more liquidations," and asked Cho "do you guys have any big accounts coming in?" *H.T.*,
8 p. 2810. Cho advised Wing that "It's going to take some time for us to build good brokers and
9 traders." *H.T.*, p. 2810. He also talked with Cho about EVFL, the currency market and where he
10 thought it was headed. *Exh. S-35a*, p. 40, 41. Cho "would ask him questions like, how's business?
11 How's Eastern Vanguard doing? And, you know, he's very upbeat. His English is not so good, but
12 trying to kind of motivate me." *H.T.*, pp. 2811-12. He told Cho that Eastern Vanguard would
13 continue to grow and wanted to expand. *H.T.*, p. 2812. Wing and Tam spent a lot of time together.
14 *H.T.*, p. 2811. Tam told Cho that EVFL "is part of" EVGL. *Exh. S-35a*, p. 50.

15 At all relevant times, the withdrawal of funds by investors from EVFL trading accounts
16 required written authorization to EVFL's California bank signed by Tak, *Exh. S-46*, who was also
17 EVGL deputy Chairman. *Exh. S-151*, para. 6. In fact, Tak had signatory power on all of EVFL's
18 bank accounts, along with Sharma, *Exh. S-183*, although he was not disclosed as an EVFL officer or
19 director or shareholder. Tak's control over EVFL funds manifested the control over EVFL exercised
20 by EVGL before as well as after August 1, 1997.

21 At all relevant times, EVGL was a controlling person of EVGL, by itself and collectively
22 with Sharma, Wing and Tak.

23 *Wing*

24 All Respondents except Simmons stipulate that Wing is a resident of Hong Kong and was
25 chairman of EVGL at all relevant times in this matter. *Exh. S-151*, para. 5. Simmons has not
26 contested these facts. Wing has also been an EVGL director since May 2, 1994, *H.T.*, pp. 1541-42,

1 *Exh. S-162c*, apparently one of only two. *Exh. S-162b*. Percy Lung, the chief dealer at EVFL's
2 Macau office testified that "the big boss of this company" is Wing, "my boss" and "the boss of
3 everybody directly." *Exh. S-82, p. 31*. This was unchanged since before "my company told me to go
4 to -- to move to Macau" from Hong Kong in 1994 where "we set up an office" when Hong Kong
5 passed a foreign currencies trading ordinance restricting EVFL from doing business with "customers
6 in Hong Kong" or placing orders with Hong Kong banks. *Exh. S-82, pp. 21-22, 29, 31, 45-46*.

7 EVGL became the sole shareholder of EVFL effective August 1, 1997. *Exhs. S-74a; S-74b;*
8 *S-74e*. EVGL chairman Wing executed the EVFL "Memorandum" authorizing the share transfer,
9 *Exh. S-74a*, as well as the EVFL "Resolution" appointing Alwin Yam as EVFL director in place of
10 Sharma. *Exh. S-74c*.

11 Chief EVFL dealer Lung said that his "superiors" in Hong Kong, including Wing, "travel all
12 over the world." *Exh. S-82, p. 34*. Cho testified that while he worked at Tokyo in 1995 and 1996,
13 Wing visited the Tokyo office in San Francisco several times to "check the office and their other
14 offices that they were doing business with in the United States." *H.T., pp. 2723-24*. Wing usually
15 "visits all the offices." *H.T., p. 2815*. Cho understood that Wing "was kind of in charge or had a big
16 say" in regard to the FISC and Tokyo offices. *H.T., p. 2814*.

17 Q. And where did you get that understanding from?

18 A. Mr. Tam call him big boss to me. Big boss is coming in town. And every time he
19 gets in town, he's always with him and giving him all the attention in the world.

20 *H.T., p. 2815*. Wing visited the FISC office in 1996 shortly after it opened, where he met and
21 spoke with Dan Hoesch. *H.T., p. 2469*. Hoesch knew him to be the chairman of the board and boss
22 of Eastern Vanguard. *H.T., pp. 2469-70*. Wing again visited the FISC office with Tam in the spring
23 of 1997 while Cho was marketing manager and stayed for two to four days at the Phoenix "staff
24 apartment" where Cho lived rent-free. *H.T., pp. 2470, 2809, 2811; Exh. S-35a, pp. 31, 39, 40, 49-50,*
25 *51*. Wing and Tam came into the office each of these days but one and Wing asked Cho questions
26 about how business was going at FISC. *Exh. S-35a, p. 40*. Wing "said specifically that FISC do
more liquidations," and asked Cho "do you guys have any big accounts coming in?" *H.T., p. 2810*.

1 Cho advised Wing that "It's going to take some time for us to build good brokers and traders." *H.T.*,
2 *p. 2810*. He also talked with Cho about EVFL, the currency market and where he thought it was
3 headed. *Exh. S-35a, p. 40, 41*. Cho "would ask him questions like, how's business? How's Eastern
4 Vanguard doing? And, you know, he's very upbeat. His English is not so good, but trying to kind of
5 motivate me." *H.T., pp. 2811-12*. He told Cho that Eastern Vanguard would continue to grow and
6 wanted to expand. *H.T., p. 2812*. Wing and Tam spent a lot of time together. *H.T., p. 2811*. Tam told
7 Cho that EVFL "is part of" EVGL. *Exh. S-35a, p. 50*.

8 At all relevant times, Wing was a controlling person of EVFL, individually and collectively
9 with Sharma, EVGL and Tak.

10 **Tak**

11 All Respondents except Simmons stipulate that Tak is a resident of Hong Kong and was
12 deputy Chairman of EVGL at all relevant times. *Exh. S-151, para. 6*. Simmons has not contested
13 these facts. Tak became EVGL Secretary on August 1, 1994. *H.T., pp. 1542-44; Exh. S-162d*. Percy
14 Lung, the chief dealer at EVFL's Macau office testified that Tak was "my boss" and a director "in
15 the company." *Exh. S-82, pp. 31-33*. This has been unchanged since before "my company told me to
16 go to -- to move to Macau" from Hong Kong in 1994 where "we set up an office" when Hong Kong
17 passed a foreign currencies trading ordinance restricting EVFL from doing business with "customers
18 in Hong Kong" or placing orders with Hong Kong banks. *Exh. S-82, pp. 21-22, 29, 31, 45-46*.
19 "Firgal Consultants Limited" was renamed EVFL on August 9, 1994. *Exh. S-49*. At all relevant
20 times, the withdrawal of funds by investors from EVFL trading accounts required written
21 authorization to EVFL's California bank signed by Tak, *Exh. S-46*, who was also EVGL deputy
22 Chairman. *Exh. S-151, para. 6*. In fact, Tak had signatory power on all of EVFL's bank accounts,
23 along with Sharma, *Exh. S-183*, although he was not disclosed as an EVFL officer or director or
24 shareholder.

25 Chief EVFL dealer Lung said that his "superiors" in Hong Kong, including Tak, "travel all
26 over the world." *Exh. S-82, p. 34*. Cho testified that while he worked at Tokyo in 1995 and 1996,

1 Tak visited the Tokyo office in San Francisco several times to "check the office and their other
2 offices that they were doing business with in the United States." *H.T.*, pp. 2723-24.

3 At all relevant times, Tak was a controlling person of EVFL, individually and collectively
4 with Sharma, EVGL and Wing.

5 **V.**
6 **RELIEF REQUESTED**

7 In light of the foregoing, the Division requests that the Commission grant the following
8 relief against Respondents.

9 **A. Cease and Desist Order**

10 Pursuant to A.R.S. § 44-2032, FISC, EVFL, Simmons and Cho should be ordered to
11 permanently cease and desist from violating A.R.S. §§ 44-1841, 44-1842 and 44-1991, and Sharma,
12 Cheng, Yuen, Tokyo and Tam should be ordered to permanently cease and desist from violating
13 A.R.S. § 44-1991.

14 **B. Order of Restitution**

15 Pursuant to A.R.S. § 44-2032(1) and to A.A.C. R14-4-308(C)(1) and (B)(1)(b), Respondents
16 should be ordered to pay monetary restitution to investors as follows:

17 FISC and EVFL, jointly and severally together with controlling persons Cheng, Yuen,
18 Tokyo, Tam, Guo, Sharma, EVGL, Wing and Tak (collectively the "above Respondents"), should
19 pay the total amount of \$336,086.41 to those investors who suffered losses as shown on Exh. S-138,
20 together with interest pursuant to A.A.C. R14-4-308 from the dates of investment at the statutory
21 rate of ten percent per annum;

22 Simmons should pay the total amount of \$99,447.69, together with interest pursuant to
23 A.A.C. R14-4-308 from the dates of investment at the statutory rate of ten percent per annum, of
24 which \$3,753.80 plus interest should be paid jointly and severally with the above Respondents to
25 Peter Baker who invested while Simmons was FISC marketing manager, and \$95,693.80 plus
26 interest should be paid jointly and severally with Cho and the above Respondents to Simmons'

1 investor clients Alan and Debbie Davis, Dean and Melba Davis, Michael Noriega, and Van and
2 Ruth Shumway, all for their losses as shown on Exhibit S-138;

3 Cho should pay the total amount of \$320,872.58, together with interest pursuant to A.A.C.
4 R14-4-308 from the dates of investment at the statutory rate of ten percent per annum, of which
5 \$225,178.69 plus interest should be paid jointly and severally with the above Respondents to all
6 except Simmons' clients who invested while Cho was FISC marketing manager, and \$95,693.89
7 plus interest should be paid jointly and severally with the above Respondents and Simmons to
8 Simmons' clients, all for their losses as shown on Exhibit S-138.

9 **C. Order Rescinding EVFL Contracts with Investors**

10 Pursuant to A.R.S. § 44-2032 and to correct the conditions resulting from Respondents'
11 violations of the SAA, all written agreements between EVFL and its accountholders who invested
12 through FISC should be ordered rescinded.

13 **D. Administrative Penalties**

14 Pursuant to A.R.S. § 44-2036(A), the primary respondents should be assessed administrative
15 penalties in an amount not to exceed five thousand dollars for *each* SAA violation. From the
16 foregoing review of evidence, it is evident that FISC, EVFL, Simmons and Cho violated the
17 antifraud and both registration provisions of the SAA in connection with each sale of an EVFL
18 security for which the Division is seeking restitution. Moreover, the other primary Respondents --
19 Sharma, Cheng, Yuen, Tokyo and Tam -- repeatedly violated the SAA's antifraud provision in
20 connection with multiple sales of EVFL securities. The Division alleged eight separate acts that
21 *each* constituted a *separate* violation of the SAA antifraud provision in connection with *each sale* of
22 an EVFL security. Therefore, these Respondents are subject to cumulative penalties for multiple
23 violations.

24 ***FISC and EVFL***

25 FISC and EVFL made untrue statements of material fact to the Commission in their no-
26 action letter request to the Division dated August 23, 1996. *Exh. S-61*. Under a heading "FISC's

1 Proposed Business," this request described the business conducted by FISC as something that *will*
2 happen. *Exh. S-61, pp. 2-3*. In fact, FISC had been offering and selling EVFL trading accounts
3 within and from Arizona since it opened in April 1996, and had been engaged in a vigorous
4 telemarketing campaign since late July. *H.T., pp. 1725, 1743*. Furthermore, the solicitation and
5 recruiting of investors by fraudulent means did not abate while this request was pending or even
6 after its denial, nor was the request and its disposition ever disclosed to investors.

7 Twenty-one investors purchased EVFL securities through FISC, *Exh. S-138*, each purchase
8 in violation of the antifraud and both registration provisions of the SAA. The Division has alleged
9 eight separate acts that each violated the antifraud provision alone in connection with each sale.
10 These two Respondents should be assessed administrative penalties in the amount of \$150,000 each.

11 ***Sharma***

12 For eight antifraud violations in connection with each sale of an EVFL security to 15⁵⁷
13 investors through FISC before August 1, 1997, Sharma should be assessed administrative penalties
14 in the amount of \$100,000.

15 ***Simmons***

16 For eight antifraud violations in connection with each sale of an EVFL security to six⁵⁸
17 investors, together with two non-registration violations for each sale, Simmons should be assessed
18 administrative penalties in the amount of \$25,000

19 ***Cho***

20 This Respondent has done little since his college days but sell Forex investments to bring in
21 income. Before he worked for Tokyo, he had associated with two Forex investment firms in
22 California that were subjects of administrative orders by California securities regulators halting their
23 illegal offer and sale of Forex investments.

24
25 ⁵⁷ K. Schnad, E. Benson, Bahamas/BSI, D. & M. Davis, S. Becker, B. Stamford, A. & D. Davis, J. Saxon,
W. Thomas, M. Noriega, M. Barry, V. & R. Shumway, Y. Choi, W. Fox and M. Unlucomert. *Exh. S-138*.

26 ⁵⁸ D. & M. Davis, A. & D. Davis, M. Noriega, V. & R. Shumway, Chad Lares and P. Baker. *Exh. S-138*. All
except Lares and Baker opened their accounts with Simmons as their trader.

1 Cho came to work for FISC to raise investor money. Before he even came to Phoenix, he
2 knew that there was not much business at FISC. *H.T.*, p. 2760. Only one trader was active there.
3 *H.T.*, p. 2760. Tam was concerned about increasing business. *H.T.*, p. 2763.

4 Q. How concerned was he?

5 A. Well, he did say, you know, we haven't had much performance the past year, a lot of
6 money has been spent, and that -- that they were going to give another try before closing. If
no performance the following year, that the people in charge, that they might close down the
Phoenix office.

7 *H.T.*, pp. 2763-64. Cho turned down Tam's initial offer to leave Tokyo for FISC because
8 Tam wouldn't pay him what he wanted. *H.T.*, p. 2762. In early December, 1996, Cho took the job in
9 Phoenix when Tam offered him more than he was making at Tokyo. *H.T.*, pp. 2766, 2763. Tam
10 expected Cho "to hire or train new traders, trainees, brokers to bring in accounts." *H.T.*, p. 2766.
11 Tam specifically discussed the problem of lack of investors with Cho. *Exh. S-35a*, pp. 67-68.

12 Q. And did you have anything particular in mind as to how you could solve the problem
there?

13 A. Can you repeat the question again, please.

14 Q. Did you have any ideas as to how you could get clients for FISC when you made the
decision to accept the job?

15 A. Yes, I did.

16 Q. And what were those ideas.

17 A. Same thing what we were doing at Tokyo International Investment.

18 Q. Which would include running ads and inviting applicants to undergo training to
become traders?

19 A. Correct.

20 Q. Were you aware whether that activity had already been going on at FISC?

21 A. Yes.

22 Q. And why did you think you could do it better than what had already been done and
failed?

23 A. Because I've done it in San Francisco and in Los Angeles.

24 *Exh. S-35a*, p. 68. Tam had told Cho that Dionisio "didn't really work hard" and was a
25 "chicken." *H.T.*, p. 2755. Cho came to Phoenix to ramrod ailing investor recruitment at FISC. Trader
26 Dan Hoesch testified that Cho's arrival at FISC in January 1997 "energized the office." *H.T.*, p.
2480. With Tam, Cho urged the traders to get clients. "That's -- that's how we'd stay in business,"
testified Hoesch. *H.T.*, p. 2483. Cho repaid Tam's confidence in him with the recruitment of 18
investors before he left ten months later.

1 Cho didn't give up this game and bail out until he realized that his activities at FISC had
2 come under regulatory scrutiny. He admitted he was aware of the Division investigation before he
3 left as FISC marketing manager. *Exh. S-35a, p. 95*. Division investigative subpoenas were served at
4 the FISC office on August 25, 1997, but none of them named Cho. *Exhs. S-171; S-172; S-173; S-*
5 *174; S-175*. Cho saw them that day and discussed them with Tam. *H.T., p. 2939*. By September,
6 Cho had decided to jump ship from FISC, but kept it to himself. *H.T., pp. 2243-44*. Tam appeared
7 and testified before the Division on October 9, 1997. *Exh. S-37a*. Cho conversed with Tam about his
8 examination under oath. *H.T., pp. 2939, 2946*. Cho subsequently informed Tam he was resigning
9 from FISC and left at the end of that month. *Exh. S-35a, p. 13*. When he left, Cho told Simmons
10 about the investigation but lulled him "that everything was fine." *H.T., p. 2840*. Despite knowing
11 about Simmons' untrue statements to Al Davis, Cho made no recommendation to Tam about
12 Simmons. *H.T., pp. 2941, 3023*. Cho wanted Simmons to stay at FISC to be his fall guy.

13 After Cho officially resigned from FISC at the end of October, 1997, he stayed in Phoenix
14 and considered starting his own currency trading company there. *H.T., pp. 2936-37*. He finally left
15 for greener pastures in early January 1998 to become a manager and trade client Forex accounts
16 again at Sky-Link Investments in Santa Ana, California, until he worked until the end of April. *H.T.,*
17 *pp. 2638-39, 2955-2957*. Cho admitted that some managers at Sky-Link "were making
18 misrepresentations, were making false statements." *H.T., p. 2641*. This firm was dealing through
19 Currex International Corporation ("Currex") in Los Angeles. *H.T., pp. 2639-40, 2957-2958*. A
20 month and a half after Cho left Sky-Link, the California Department of Corporations issued a
21 "Desist and Refrain Order" against Currex prohibiting it from illegally offering or selling
22 unregistered foreign currency contracts. *H.T., p. 2959; Exh. S-180*.

23 In view of the foregoing, Cho should be assessed administrative penalties in the amount of
24 \$100,000 for eight antifraud violations in connection with each sale of an EVFL security to 18⁵⁹

25
26 ⁵⁹ K. Schnad, E. Benson, Bahamas/BSI, D. & M. Davis, S. Becker, B. Stamford, A. & D. Davis, J. Saxon,
W. Thomas, M. Noriega, M. Barry, L. Min, V. & R. Shumway, B. Shalz, Y. Choi, J. Nagorny, W. Scott and M.

1 investors, together with two non-registration violations for each sale.

2 **Cheng**

3 For eight antifraud violations in connection with each sale of an EVFL security to 21
4 investors, *Exh. S-138*, Cheng should be assessed administrative penalties in the amount of
5 \$100,000.

6 **Yuen**

7 For eight antifraud violations in connection with each sale of an EVFL security to 21
8 investors, *Exh. S-138*, Yuen should be assessed administrative penalties in the amount of \$100,000.

9 **Tokyo**

10 For eight antifraud violations in connection with each sale of an EVFL security to 21
11 investors, *Exh. S-138*, Tokyo should be assessed administrative penalties in the amount of \$100,000.

12 **Tam**

13 For eight antifraud violations in connection with each sale of an EVFL security to 21
14 investors, *Exh. S-138*, Tam should be assessed administrative penalties in the amount of \$100,000.

15 **E. Other Relief**

16 The Division further requests any other relief that the Commission in its discretion deems
17 appropriate and authorized by law.

18 RESPECTFULLY SUBMITTED this 26th day of April, 1999.

19 JANET NAPOLITANO
20 Attorney General
Consumer Protection & Antitrust Section

21 By: 

22 MARK C. KNOPS
23 Special Assistant Attorney General
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25 Arizona Corporation Commission
26

Unlucomert. *Exh. S-138*. Saxon and Choi opened their accounts with Cho as their trader. *Exh. S-35a*, pp. 68-69.

1 ORIGINAL AND TEN (10) COPIES of the foregoing
2 filed this 26th day of April, 1999, with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington
6 Phoenix, AZ 85007

7 COPY of the foregoing mailed and/or faxed this
8 26th day of April, 1999 to:

9 James Charles Simmons, Jr.
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